

***United States Court of Appeals  
for the Second Circuit***



**BRIEF FOR  
APPELLANT**



To be argued by  
JOSEPH J. SANTORA

ORIGINAL **76-7050**

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**United States Court of Appeals**  
**FOR THE SECOND CIRCUIT**

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MARX & Co., Inc., JOHN V. SUMMERLIN, JR., OTTO MARX, JR.,  
WILLIAM D. FUGAZY and LOUIS V. FUGAZY,

*Plaintiffs-Cross-Appellants,*

*against*

THE DINERS' CLUB, INC., DINERS/FUGAZY TRAVEL, INC.,  
THE CONTINENTAL CORPORATION and THE CONTINENTAL  
INSURANCE COMPANY,

*Defendants-Cross-Appellees,*

THE DINERS' CLUB, INC., DINERS/FUGAZY TRAVEL, INC.,

*Defendants-Appellants,*

*against*

WILLIAM D. FUGAZY, LOUIS V. FUGAZY, JOHN V. SUMMERLIN,  
JR., OTTO MARX, JR., MARX & Co., Inc. and F.T.  
VENTURES, INC.,

*Plaintiffs-Appellees.*

ON APPEAL FROM AN ORDER AND JUDGMENT OF THE UNITED  
STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT  
OF NEW YORK

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**BRIEF FOR DEFENDANTS-APPELLANTS**

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## BRIEF FOR DEFENDANTS-APPELLANTS

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### Preliminary Statement

This appeal is taken by The Diners' Club, Inc. ("Diners") and Diners/Fugazy Travel, Inc. ("DFT"), the defendants-appellants herein, pursuant to 28 U.S.C. Sec. 1291, from the final judgment entered herein on January 6, 1976 by the United States District Court for the Southern District of New York (Hon. Robert J. Ward) as set forth in appellants' Notice of Appeal. This is a Civil Action which has been consolidated for all purposes. Jurisdiction is predicated on the Securities Exchange Act

of 1934 ("the 1934 Act") and Rule 10-b(5) promulgated thereunder. The trial of this action before the Court and a jury was concluded on May 28, 1975. The issues raised on this appeal relate only to the portions of the judgment which awarded damages against Diners in the amount of \$533,000 to plaintiffs William D. Fugazy, Louis V. Fugazy, Otto Marx, Jr. and John V. Summerlin (hereafter collectively referred to as "the Fugazys"), and dismissed the counterclaims of Diners and DFT.

In this action, the Fugazys alleged that defendants had engaged in a course of conduct from 1967 through 1970 which constituted a fraud upon the Fugazys. In support of their fraud claim, the Fugazys alleged various specific transactions in their complaints arising out of an agreement between Diners and the Fugazys dated October 10, 1967 (\*Ex. 5, A-513) ("the Contract") whereby Diners purchased from the Fugazys the assets of their company, Fugazy Travel Bureau, Inc., and related transactions. The Fugazys abandoned a portion of their fraud claim on the eve of trial and were denied recovery on every other aspect of their fraud claim. However, at trial the Fugazys transformed one fraud allegation—to the effect that Diners filed a Registration Statement, but then fraudulently refused to cause the Registration Statement to become effective—into a claim for breach of contract. In addition the Fugazys added to this allegation a new claim that Diners breached the Contract with respect to the filing of the Registration Statement. (The claims of breach of contract are referred to herein as the "1969 claim".) Although no formal amendment to the complaint was made, the Court implicitly deemed the complaint amended to treat the 1969 claim as a contract claim. The jury awarded contract damages to the Fugazys on their 1969 claim, and also ruled against Diners

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\* The letters "Ex." followed by numerals denote references to exhibits received in evidence at the trial of this action. The letter "D" followed by numerals denotes references to documents listed in the Index to the Record on Appeal in this action. All page references, including reference to the trial transcript, are cited to the Joint Appendix, and are designated by "A-       ".

and DFT on the counterclaims. The post-trial motions of Diners and DFT seeking, *inter alia*, judgment notwithstanding the verdict, were denied by the Court. (400 F. Supp. 581)

On this appeal, Diners seeks judgment in its favor on the 1969 claim, or, in the alternative, a new trial. Diners and DFT also seek judgment in their favor, or, in the alternative, a new trial on their counterclaims. It is respectfully submitted that the facts and authorities cited herein demonstrate that the issues presented below should be determined in favor of appellants, and that the subject decisions of the Court below with respect to the 1969 claim and the counterclaims should be reversed.

### **Statement of Issues Presented**

1. Did the Court below err in refusing to apply the defense of accord to bar the Fugazys' claim of a prior breach of contract on the basis of F.R.C.P. Rule 8(c), because accord had not been pleaded in Diners' answers to the complaints?
2. Did the Court below err in refusing to grant Diners' motions for directed verdict and judgment notwithstanding the verdict on the Fugazys' claim that Diners breached the Contract by deeming that the Fugazys' undisputed non-performance of conditions precedent in the Contract was excused?
3. Did the Court below err in refusing to grant Diners' motion for judgment notwithstanding the verdict which contended that the jury's verdict on the 1969 claim was against the overwhelming weight of the evidence?
5. Did the Court below err in permitting the Fugazys' expert witness, qualified as an expert in securities regulations, to improperly and incorrectly construe the rights and obligations of the parties in the Contract, and testify as to the legal consequences of the terms and provisions of the Contract?

6. Did the Court below err in taking judicial notice of a statistic of the Securities Exchange Commission ("S.E.C.") which was erroneous, irrelevant, incompetent, confusing and highly prejudicial to Diners?

7. Did the Court below commit additional errors relating to the testimony of the Fugazys' expert, his use of the S.E.C. statistic and other matters sufficient to require that Diners be granted a new trial on the 1969 claim?

8. Did the Court below err in refusing to grant Diners' and DFT's motions for directed verdict and judgment notwithstanding the verdict on the counterclaims when undisputed evidence established that the Fugazys had defrauded Diners and DFT and had breached their contractual and fiduciary duties to Diners and DFT?

9. Did the Court below abuse its discretion in refusing to grant the motion of Diners and DFT for a new trial on the counterclaims, on the basis of prejudicial errors committed at the trial, and on the further basis that the jury's verdict was against the weight of the evidence?

### **Statement of the Case**

This action was commenced by plaintiffs Marx and Summerlin in 1970 and by plaintiffs William and Louis Fugazy in 1972. The complaints in both actions and defendants' answers thereto are virtually identical and are hereafter referred to as "the complaint" and "the answer". The actions were consolidated for all purposes in 1973.

The Fugazys alleged a single cause of action in their complaint (D. 33, p. A-14, D. 161, p. A-472, par. 9-11) claiming that commencing prior to its purchase of Fugazy Travel in 1967, Diners and the other defendants, including Continental Corporation ("Continental") embarked upon a scheme to defraud the Fugazys, by inducing them to part with the assets of Fugazy Travel on representations that Continental was going to "take over" Diners, which would allegedly result in an appreciation in value of the Diners'

stock received by the Fugazys pursuant to the Contract. They further alleged, in their single 10b-5 cause of action, that the defendants continued that scheme in 1968, through the same representations, by inducing the Fugazys to relinquish certain cash benefits under their employment agreements, in return for additional Diners' stock. The Fugazys further alleged that these representations of a Continental "take over" were continued through 1969, while the defendants continued their scheme by intentionally driving down the earnings of Diners' and DFT and the price of Diners' stock in order to permit the takeover to occur at a lower price to Continental. Finally, the Fugazys alleged that, as part of this fraudulent scheme, Diners had represented in 1967 that it would use its best efforts to cause a Registration Statement to become effective, and that such representation was false since Diners never intended to, and did not in 1969, use its best efforts to cause the Registration Statement, covering the Diners' stock obtained by the Fugazys in 1967, to become effective. The Court's jurisdiction was predicated solely on the 1934 Act. (D. 33, p. A-14, D. 161, p. A-472).

In their answer, defendants denied all allegations of fraud and misrepresentation, and asserted various affirmative defenses to the Fugazys' Rule 10b-5 claim. In addition, Diners and DFT asserted counterclaims arising out of the same transactions complained of by the Fugazys which alleged that the Fugazys had defrauded Diners in violation of Rule 10b-5 in connection with the 1967 asset purchase, and that the Fugazys, as officers or directors of Diners and DFT, had breached contractual and fiduciary duties to Diners and DFT (D. 46, p. A-25, D. 168, p. A-482).

Throughout the five years of pre-trial litigation of this action, thousands of pages of deposition testimony and additional extensive discovery activities were conducted on the Fugazys' fraud claim, defendants' defenses thereto, and the counterclaims.

The trial commenced on May 6, 1975. During the trial, the Court dismissed the portion of the Fugazys' claim

relating to the 1967 asset purchase. That decision is the subject of the Fugazys' instant cross-appeal. The jury found in favor of defendants on the portion of the claim relating to the amendment of the Fugazys' employment agreements, and the jury's verdict has not been appealed by the Fugazys. The portion of the claim relating to the Registration Statement—the 1969 claim—was transformed at the trial into a breach of contract claim, and, on May 28, 1975, the jury awarded damages to the Fugazys on that claim. Virtually all the evidence offered on that claim by the Fugazys was presented on rebuttal on the last day of trial. The jury also denied recovery on the counterclaims. Defendants Diners and DFT moved for judgment notwithstanding the verdict, a new trial and remittitur of damages on various grounds, each of which was dispositive of the verdict on the 1969 claim or the counterclaims. However, the Court denied the motions in every respect (D. 145, p. A-403).

The Fugazys subsequently moved, *inter alia*, for pre-verdict interest on the damages of \$533,000 awarded on the 1969 claim, contending that the 1969 claim had become a contract claim under New York State Law. The Court deemed the Fugazys' complaint to be implicitly so amended, and awarded the Fugazys interest on the \$533,000 damage award from September 2, 1969, under the law of New York. In determining the date for the running of interest, the Court based its decision on the fact that the jury's verdict was predicated on a finding that the Registration Statement for the Fugazys' shares should have become effective by August 29, 1969. (D. 157, p. A-456) The Court denied the request of the Fugazys for costs and granted costs to Continental and Continental Insurance. The judgment which gives rise to this appeal was entered on January 6, 1976. (D. 158, p. A-464) The portions of the judgment relating to the Fugazys' 1969 claim and the counterclaims are the subjects of the instant appeal.

## Statement of Facts Relating to the Fugazys' 1969 Claim

### A. The Fugazys

The Fugazys, at various times from October, 1967 through 1970, served as officers or directors of DFT. In April, 1969, the Fugazys were officers of DFT and, from April, 1968 through February, 1969, William Fugazy was president of Diners. Throughout 1969, William Fugazy was also a director of Diners. The Fugazys held these positions pursuant to employment agreements which were an integral part of, and executed pursuant to, the Contract. For several years prior thereto, William and Louis Fugazy had been operating Fugazy Travel Bureau ("Fugazy Travel") together with Marx and Summerlin. Marx was an investment banker who engaged in the purchase and sale of companies, and was a sophisticated businessman fully knowledgeable of all aspects of the registration of stock and the filing of a registration statement for restricted shares of stock. (A-1255, A-1368)

### B. The Pleadings and the Pre-Trial Order

Paragraph 11 of the complaint sets forth the various alleged manipulative and fraudulent devices complained of by the Fugazys. The only reference to the transaction which has now emerged as the 1969 claim appears in par. 11(h), as follows:

- "11. The aforesaid *unlawful employment of manipulative and deceptive devices* in connection with the purchase or sale and related transactions with respect to the shares of Diners' Common Stock owned by plaintiffs *was effectuated by various means and methods* including, but not limited to, the following:

\* \* \* \*

- (h) . . . Pursuant to the foregoing provisions of the Purchase Agreement [§ 10.2(b)], defendant *Diners filed a registration statement* (Form No.

S-1) with the Securities and Exchange Commission on August 28, 1969, *but failed and refused to use its best efforts* to cause such registration statement to become effective." (D. 33, par. 11, p. A-18) (Emphasis Added)

Paragraph 12 of the complaint alleges that the representations described in par. 11 were false and constituted manipulative and deceptive devices employed by defendants to induce the Fugazys to acquire and retain shares of Diners from October 10, 1967, to February 6, 1970. The Diners shares were issued to F. T. Ventures (formerly known as Fugazy Travel Bureau, Inc.) as part of the consideration for the Contract and the amendment of the employment agreements in 1968 and constitute the shares involved in the Fugazys' fraud claim relating to those transactions, the defenses of defendants thereto and defendants' counterclaims.\* They are also the same Diners shares for which the Fugazys were awarded damages on the 1969 claim. Defendants' answer denied the claim of fraud and asserted affirmative defenses thereto, along with counterclaims addressed to the same transactions.

In the Pre-Trial Order, jurisdiction was predicated on the 1934 Act (D. 115, p. A-48) and the Fugazys' contentions concerning the 1969 claim were as follows:

"8. Section 10.2(b) of the Purchase Agreement entered into between the . . . plaintiffs and the defendant Diners on October 10, 1967 (Purchase Agreement) required the defendant Diners, *inter alia*, to file a Registration Statement registering the shares of common stock of Diners held by the . . . plaintiffs.

9. Pursuant to the foregoing provisions of the Purchase Agreement the defendant Diners, on August 28, 1969, *filed a registration statement* (Form S-1) with the Securities and Exchange Commission, *but failed*

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\* FT Ventures was subsequently dissolved and the Fugazys, the former shareholders, are the successors in interest to the dissolved corporation.

*and refused to use its best efforts to cause such registration statement to become effective.*" (D. 115, p. A-56, par. 8 and 9, p. A-58, par. 8 and 9) (Emphasis Added)

On the eve of trial, the 1969 claim was clearly a fraud claim under Rule 10b-5 and no indication was given that the Fugazys claimed any breach of contract. It was clear that there was no allegation that the Fugazys claimed any impropriety concerning the filing of the Registration Statement, which was implicitly treated as proper by the Fugazys; it was also clear that the Fugazys' complaint dealt solely with the question of "best efforts" subsequent to the filing.

### **C. The Contract**

The provisions of the Contract which are the focus of this appeal are Sections 10.2(b) and 10.2(c):

"10.2(b) . . . [T]he registered holders thereof (but not less than all of them) may, at any time after January 1, 1969, notify Diners that they desire that Diners file such a registration statement, but only with respect to all such shares then owned by all such holders. Unless Diners shall have received an opinion from its counsel that registration is not required, or if Diners and all such registered holders, together proceeding expeditiously and in good faith after such notice, cannot obtain from the Securities and Exchange Commission a 'no-action' letter with respect to the sale of such shares, then Diners shall promptly file a registration statement and use its best efforts to cause such registration statement to become effective. Diners may include in such registration statement such other of its securities as it may desire. Anything to the contrary notwithstanding, Diners need not file any such registration statement until it may lawfully use its regularly prepared fiscal year end financial statements, as a part of such registration statement. The notifying holders shall pay Diners in advance an amount sufficient to reimburse

Diners for one-half of all registration fees, printing costs, auditing fees (but only in excess of normal fees paid by Diners for its fiscal year end audit), legal fees and all other incidental out-of-pocket expenses incurred in connection with such registration statement."

Section 10.2(c) provides as follows:

"10.2(c) Any registration by Diners of shares of Common Stock bearing the legend provided for in Section 10.1(c), whether under paragraph (a) or (b) of this Section 10.2, shall be conditioned upon the holders of such shares delivering to Diners, its officers, directors and any person controlling Diners within the meaning of the Securities Act of 1933 an indemnity agreement, in customary form, indemnifying such persons against liabilities based on untrue statements in or omissions from the registration statement made in reliance on information furnished by Diners by such holders. Diners shall correspondingly indemnify such holders for statements made therein which are furnished by Diners." (Ex. 5, pp. A-556, A-557)

Thus, subject to the various terms and conditions of Sections 10.2(b) and 10.2(c) of the Contract, the Fugazys were permitted, subsequent to January 1, 1969, "to notify Diners that they desire that Diners file" a Registration Statement for their Diners shares. The Contract thus provides that the obligation of Diners to promptly file the Registration Statement arose only after:

- 1) notification by all of the registered holders,
- 2) the mutual attempt to find the basis to obtain a no-action letter from the SEC in lieu of registration or opinion of counsel that registration is not necessary,
- 3) Diners was able to use its regularly prepared fiscal year end financial statements in connection with the Registration Statement,

- 4) the advance payment to Diners by the notifying holders of an amount sufficient to reimburse Diners for one-half the fees and expenses connected with the registration statement (the "Payment Condition"), and
- 5) the delivery by the notifying holders to Diners of an indemnity agreement in customary form (the "Indemnity Condition").

Diners was expressly authorized by the Contract to include in the Registration Statement shares other than those of the Fugazys, without limitation. Only after the filing of the Registration Statement could Diners' obligation to use its best efforts to make the Registration Statement effective arise. That obligation only required Diners to use its best efforts, and did not require that a registration statement actually become effective at any time.

**D. The Fugazys' Notification to Diners Under Section 10.2(b) of the Contract**

Although entitled to give notification following January 1, 1969, the Fugazys did not do so for almost three months (Ex. 27, p. A-661). Their notification, dated April 16, 1969, was received by Diners on or about April 20, 1969 (Ex. 27, p. A-661, Ex. 28, p. A-663). In their notification, the Fugazys advised Diners as follows:

"In connection with such registration, the undersigned are prepared and offer to advance you an amount sufficient to reimburse you for one-half of all registration fees and expenses as provided in said paragraph 10.2(b) and to furnish the indemnity agreement referred to therein." (Ex. 27, p. A-661)

The Fugazys did not include any payment with their notification and never, at any time, made any payment to Diners as required by Section 10.2(b) of the Contract (Ex. P, p. A-818; A-1325-A-1327). The Fugazys did not include an indemnity agreement with their notification as required by Section 10.2(c) of the Contract, and did not

furnish Diners with any indemnity agreement until August 27, 1969 (Ex. IIII, p. A-894). The Registration Statement was filed on August 28, 1969 (Ex. 30, p. A-666).

The Fugazys never considered the registration of their shares a necessity and were amenable to any method of obtaining money for their shares (A-1319). Several previous requests had been made to Mr. Johnson of Continental for Continental to buy the Fugazys' shares without registration (A-1404, A-1315-A-1316). On April 24, 1969, Mr. Johnson sent a memorandum to Mr. Herd of Continental indicating his belief that the Fugazys' notification (Ex. 27, p. A-661) was another effort to have Continental purchase the Fugazys' shares and indicated his reaction was to do nothing "at the present time" with respect to that effort (Ex. 29, p. A-665). The Fugazys confirmed that belief by initiating and pursuing alternatives to registration through June, 1969 (Ex. 55, p. A-799, MMM, p. A-873, NNN, p. A-876, OOO, p. A-878) and continued the discussions in July and August, 1969 (pp. A-1319-A-1320). As late as November 18, 1969, long after the Registration Statement had been filed, the Fugazys agreed to withdraw it and suggested further alternatives to registration (Ex. MMMM p. A-903; pp. A-1322-A-1324). The matter of registration was of such minor importance to the Fugazys that William Fugazy was not sure whether he and Marx had actually agreed to withdraw the Registration Statement (p. A-1114).

#### **E. The Fugazys' Initiation of Alternatives to Registration**

Within two or three weeks following the Fugazys' notification, the Fugazys and Diners were discussing alternatives to registration in accordance with the Contract (Ex. 55, p. A-799, MMM, p. A-873). Half the cost of registration was to be borne by the Fugazys. (Ex. 55, p. A-799) Mr. Faunce of Diners recommended that Diners consider proceeding with registration "in the absence of some other alternative". (Ex. 55, p. A-799) On May 19, 1969, Marx wrote to Diners setting forth an alternative

proposal so that the Fugazys' Diners shares "would not have to be registered at this time". (Ex. MMM, p. A-873).

"I am sure you realize that this plan would eliminate the costs of a registration statement and the disclosure of a great deal of complicated information." (Ex. MMM, p. A-875)

Marx invited Diners to make additional suggestions for alternative proposals in lieu of registration and added that when he returned from Europe in a few weeks "a decision can be made to either register our shares or take some action on some alternative plan". (Ex. MMM, p. A-873)

On June 12, Marx wrote to William and Louis Fugazy that the directors of Diners, including William Fugazy, had disapproved his alternate proposal and were proceeding with the Registration Statement, reminding them that "[U]nder our Agreement we pay for half the cost of such registration statement". (Ex. NNN, p. A-876) On June 17, 1969, Marx tried to get Mr. Johnson to revive the discussion of alternatives to registration. (Ex. OOO, p. A-878) During the next few weeks of June and July, the Fugazys were aware that Diners was engaging in extensive effort and expense in proceeding with the Registration Statement (Ex. PPP, p. A-879). The Fugazys never made any objection at that time or at any time prior to the trial to the quantity or the quality of Diners' efforts in June and July to prepare the Registration Statement.

#### **F. The Inclusion of Other Shares in the Registration Statement**

The Contract authorized Diners to include in the Registration Statement such other shares as Diners "may desire". The Contract provides no limit on the number of such other shares or shareholders, and no limitations on time, expense or effort which could be involved in including such other shares. In July, 1969, Diners, including William Fugazy as director, authorized the inclusion of \$10 million worth of other shares in the Registration Statement. (Ex. FFFF, p. A-893) Mr. Fugazy informed Marx

of this on July 21, 1969. (Ex. FFFF, p. A-893) The Fugazys did not object to the inclusion of other shares. William Fugazy wrote to Marx:

“At the board meeting on Friday, we authorized the registration of \$10,000,000 of stock that will be piggy-backed with the current registration of F.T. Ventures [the survivor company of Fugazy Travel Bureau]. You might want to take this into consideration when we argue with Julian Weber [Diners’ counsel] over the expenses.” (Ex. FFFF, p. A-893)

The Registration Statement indicates that the shares of eighteen shareholders other than the Fugazys were included in the Registration Statement. (Ex. 30, p. A-666)

**G. The Fugazys’ Failure to Make the Advance Payment of Registration Expenses and Furnish the Indemnity Agreement Required by the Contract**

On July 15, 1969, Mr. Faunce of Diners reminded the Fugazys that Diners was preparing the Registration Statement and asked them to fulfill their obligation to make advance payment of half of the expenses. (Ex. PPP, p. A-879) He asked for their check “before we proceed further with the registration”. (Ex. PPP, p. A-880) The Fugazys did not make any payment and did not even respond to Mr. Faunce’s letter. At no time did they object in any way to any of the contents of Mr. Faunce’s letter.

On August 15, Julian Weber, Diners’ counsel at Botein Hays Sklar and Herzberg, repeated Mr. Faunce’s demand for payment and advised the Fugazys that “[U]pon receipt of your check in that amount, the Company is prepared to proceed to file the registration statement”. (Ex. QQQ, p. A-883) The Fugazys did not respond to Mr. Weber, but instead wrote on August 21 to Mr. Bloomington stating “[I]t does not seem feasible to pay to Diners in accordance with the aforementioned acquisition agreement ‘in advance’ an amount sufficient to reimburse Diners Club for one-half of all registration fees . . .”

(Ex. RRR, p. A-884) (Emphasis Added) The Fugazys then proposed a modification of their obligations under the Contract to permit them to pay "after the registration statement is effective" within 30 days after receipt by the Fugazys of "itemized bills" approved by the parties. In addition, on August 21, counsel for DFT was speaking to Diners' counsel on behalf of the Fugazys to reduce the scope of the indemnity agreement which the Fugazys were required to deliver to Diners by Section 10.2(c) (Ex. SSS, p. A-885).

On August 22, Weber wrote to the Fugazys advising them that the Fugazys could not be given the right to approve the bills connected with the Registration Statement and further advising them that if the Fugazys refused to give Diners an indemnity, Diners would not provide the Fugazys with an indemnity under the contract. (Ex. UUU, p. A-887, TTT, p. A-886) Marx responded on the same day, refusing to pay anything to Diners in connection with the Registration Statement unless Diners gave the Fugazys an indemnity and concluded as follows:

"We are not authorizing you to file any registration on our part or for our benefit without proper indemnification." (Ex. VVV, p. A-888)

By August 26, 1969, the Fugazys had completely failed to perform either the Payment Condition or the Indemnity Condition in the Contract. At no time prior to August 26, 1969 did the Fugazys ever advise Diners that they disputed the fact that they were obligated to perform those conditions.

#### **H. The Accord Between the Parties**

On or about August 27, 1969, Diners agreed that if the Fugazys signed and performed a written agreement acknowledging the prior Payment Condition, acknowledging their non-performance of that condition, and evidencing their undertaking to personally guarantee the obliga-

tion of F.T. Ventures, Inc. ("Ventures"), and if the Fugazys delivered indemnity agreements in the form agreed to by their respective counsel, then Diners would proceed with the filing of the Registration Statement. On or about August 27, 1969, the Fugazys signed and delivered a written agreement which provided as follows:

"You are in the process of preparing for filing with the Securities and Exchange Commission, a Registration Statement on Form S-1. That Registration Statement relates in part to shares of your Common Stock, \$1 par value, received by F.T. Ventures, Inc. in connection with the aforesaid acquisition.

*Under the aforesaid acquisition agreement, F.T. Ventures, Inc. agreed to pay you, in advance, an amount sufficient to reimburse you for half of certain of the expenses to be incurred in connection with that Registration Statement.*

*You have agreed that F.T. Ventures, Inc. need not make that advance payment.*

In consideration therefor, we each personally agree to guarantee the payment by F.T. Ventures, Inc. of one-quarter of all registration fees, printing costs, auditors fees (but only in excess of normal fees paid by you for your fiscal year end audit), legal fees and all other incidental out-of-pocket expenses incurred by you in connection with such Registration Statement; provided, however, that our guarantees as aforesaid shall be limited to the amount of \$15,000 each and provided, further, that you will forward to us copies of all bills relating to such expenses for examination. These guarantees do not, of course, limit the liability of F.T. Ventures, Inc. to reimburse you to the extent of one half of such expenses." (Emphasis added) (Ex. WWV, p. A-890)

On August 27, 1969, the Fugazys also executed and furnished to Diners the indemnity agreements. (Ex. IIII, p. A-894) The agreements reached by Diners and the Fugazys on August 27 established an accord between them with re-

spect to the Payment Condition, the Indemnity Condition and the filing of the Registration Statement. On August 28, Diners filed the Registration Statement (Ex. 30, p. A-666) fully discharging its obligations under the accord. The Fugazys never made the payment required of them under the accord. (Ex. WWW, pp. A-889-A-890) At no time prior to the trial did the Fugazys ever contend that Diners had breached its obligation under the accord or that the filing on August 28 was improper in any way.

**I. Action by the S.E.C. and Further Developments Following the Filing of the Registration Statement**

Subsequent to the August 28 filing, Diners received no comments from the S.E.C. with respect to the Registration Statement until late October, 1969. Partial comments were received on October 20 (Ex. 39, p.A-773, Ex. 40, p.A-780) and complete initial comments were not received until October 31. (p. A-1372) It is undisputed that Diners could do nothing further on the Registration Statement until the S.E.C. comments were received (p. A-1321). Pursuant to the S.E.C. comments, Diners obtained further necessary information from the Fugazys (Ex. KKKK, p.A-901, Ex. LLLL, p.A-902) and prepared and delivered responses to the S.E.C. comments on November 5 and November 11. (Ex. NN, p.A-819, Ex. PP p.A-822) Following the transmittal of these letters to the S.E.C., Diners arranged for and attended several meetings with the S.E.C. to discuss the problems raised on the S.E.C. comments. (pp.A-1119-A-1122) On November 18, 1969, the Fugazys agreed to withdraw the Registration Statement and advanced further alternative proposals to registration, which Diners considered and declined. (Ex. MMMM, p.A-903; pp. A-1322-A-1324) In December, 1969, Marx sold some of his shares privately for \$13.50 per share. (p.A-1252)

On February 6, 1970, Continental made a public tender for Diners shares. (Ex. 26, p.A-657) The Fugazys sold most of their shares to Continental at \$15 per share and the Registration Statement was eventually withdrawn.

(pp. A-1113-A-1122) The Fugazys made no objection to the withdrawal of the Registration Statement since Diners furnished them with an opinion of counsel indicating their stock could be sold. (Ex. 42, p.A-783, Ex. 43, p.A-784)

Subsequent to the August 28 filing, the market price of Diners shares steadily decreased until, by early December, it reached a level below the \$15 tender offer. (Ex. 48, p.A-785) At no time between August 28, 1969 and February 6, 1970, did the Fugazys ever complain to Diners about any possible acts or omissions of Diners in failing to achieve an effective registration. Not until Marx commenced his action in July, 1970, did the Fugazys ever allege in any way that Diners had not used its best efforts to cause the Registration Statement to become effective.

**J. Additional Facts Relating to the  
Processing of the Registration  
Statement by Diners**

The Fugazys offered no evidence to even suggest that Diners failed to use its best efforts to cause the Registration Statement to become effective or to establish any act or omission of Diners under the Contract. The only evidence on this issue was offered by Diners and such evidence established that Diners was using its best efforts. The parties were considering alternatives to registration, in accordance with the Contract, through June. (Section E *supra*) Preparation of the Registration Statement was under way in June (A-1488-A-1489) and extensive work by the accountants and lawyers had been done by July 15 (Ex. PPP, p. A-879). The financial statements from Diners' annual year end audit,\* which were required by the Contract were not ready until June 6. (Ex. 31, p. A-729) That marked the beginning of extensive work required in compiling comprehensive financial data required for a Registration Statement for the previous five years. (Ex. 30, p. A-666, A-671-A-673) This Registration Statement was also a difficult task for Diners in 1969 since Diners had not filed one since 1955. (p. A-1367) The parties en-

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\* Diners was on a fiscal year ending March 31.

tered their accord to resolve the matter of the Fugazys' non-performance of the conditions precedent on August 27, 1969 (Sections F and G *supra*) and Diners filed the Registration Statement the following day. (Ex. 30, p. A-666)

Subsequent to the filing, Diners did not receive the complete S.E.C. comments until October 31. The only evidence received on this issue shows Diners did everything possible to comply with the S.E.C. This was confirmed by plaintiff William Fugazy who was a director of Diners and who participated in many of these activities. (pp. A-1105-A-1106, A-1115, A-1119-A-1122) Fugazy testified as follows:

"Q. Did Mr. Asch ever discuss with you any comments received from the SEC concerning the financial statements of Diners' Club Inc. filed with the registration statement?

A. Yes. We had several meetings on it.

\* \* \* \*

Q. Do you recall any specific conversations that you had on this subject?

A. I recall meetings being called by Mr. Faunce to discuss the problems and completing the SEC registration.

\* \* \* \*

Q. What did Mr. Faunce say those problems were?

A. *Monumental.*

Q. Aside from being monumental, what were the problems?

A. There were all sorts of problems both in the credit card area, the travel card area, the collection agency. *All of these subsidiaries had certain problems that had to be cured or corrected before a registration would be approved by the SEC. They wanted a new accounting technique on the franchise income both for Diners' as well as Diners/Fugazy,\** some clarification on the Continental holdings where certain of the con-

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\* This company was formed in 1967 to operate the travel business purchased from the Fugazys. William Fugazy was the President from its inception to the date of the S.E.C. comments.

version rights would have to be executed. *There was a series of problems.*

Q. Were you ever present at any meeting at which any decision was made on any of these problems?

A. No, *it got to be so difficult that it became more and more apparent that the registration was going to be—excuse the expression—a monumental task to get through.*

Q. Was any negotiation to your knowledge made by Mr. Faunce as to whether Diners' Club, Inc. intended to comply with the SEC request?

\* \* \* \*

A. No, *I believe Diners' Club tried to comply with the SEC request. It got to be a very slow and tedious problem. Finally when Continental tendered, you know, it killed the whole situation. They just withdrew it. I believe that up to the time of the Continental tender that an effort was being made to comply with the SEC.*

Q. Do you know whether an effort was being made or is that your surmise?

A. No, I was not really involved with it, no. I mean, it was certainly a drawn out process, but I don't know whose fault it was. It didn't appear like they were getting anyplace." (pp. A-1120-A-1122) (Emphasis Added)

The only evidence offered by the Fugazys even remotely related to the "best efforts" issue was an irrelevant statistic of the S.E.C. (p. A-930) As they were concluding their case-in-chief, the Fugazys asked the Court to take judicial notice of that S.E.C. report, which simply showed that between June 1969 and June 1970, the *median*\* number of days in which registration statements became effective after filing was 70. The Court took judicial notice over Diners' objection. (p. A-1329) As discussed in the sections to follow, this statistic was irrelevant and incompetent on the issue of whether Diners used its best

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\* It was commonly, but erroneously referred to as an average.

efforts in this case, and was a highly prejudicial and confusing statistic which misled the jury, the Judge, counsel and witnesses and is raised on this appeal as a separate ground requiring the granting of a new trial on the 1969 claim.

### **The Fugazys' Expert Witness**

The Pre-Trial Order in this case listed no expert witness. (D. 115, p. A-48) When the Fugazys rested their case on May 14, 1975, they made no mention of any intention to call an expert or any witness on rebuttal. Only after defendants' case (in defense of the fraud claims) had commenced was there a mention of the expert, whom the Fugazys chose not to identify until 6:00 p.m. on Friday, May 16. At that time, he was identified as Stanley Friedman, an attorney, and the Fugazys indicated that they intended to present him to testify "on the registration requirements of the Securities and Exchange Commission." (D. 134 Ex. A, p. A-296) On May 19, Diners objected to the expert on the ground that he was not a proper rebuttal witness and on the ground of surprise. The Court overruled the objection. (D. 145, pp. A-412-A-413) Diners then requested information as to prior published writings of Friedman and the Fugazys advised Diners there were none. Diners subsequently discovered that Friedman had, in fact, published a number of works and requested the Fugazys to produce such works. The works were produced for the first time on May 22, 1975, at approximately 6:00 p.m., the eve of Friedman's testimony on May 23. (D. 134, pp. A-270-A-271) On May 23, the last day of testimony in the trial, Stanley Friedman testified and was qualified as an expert in securities regulations. (p. A-1503)

Friedman presented the 1969 claim, for the first time in five years of litigation, as a breach of contract claim rather than the fraud claim under Rule 10-b(5) it had been prior to May 23, 1975. Furthermore, for the first time in this case, the Fugazys, through Friedman, contended that Diners had failed to promptly file the Registration

Statement. Friedman testified that Diners should have filed it by June 20, 1969. (pp. A-1510-A-1512) He accomplished this by testifying, over objection, as to the terms and provisions of the Contract and the legal consequences thereof. He was permitted over objection to construe the legal obligations of the parties. His testimony included, for example, determinations of the law of conditions, legal excuse and waiver (pp. A-1513-A-1518, A-1560-A-1561; See Point III, *infra*)

In overruling the objections to such testimony, the Court ruled that such construction of the Contract was proper testimony for the jury and left Diners the remedy of cross-examining the expert on his conclusions. (pp. A-1509, A-1512-A-1515)

Mr. Friedman's testimony was not only directly contradictory to the express terms of the Contract (Section C, *supra*), but it also contradicted the undisputed evidence of record (Sections D, E, F, G and H, *supra*) and conflicted with the controlling legal authorities as discussed in the Argument sections, *infra*. For example, Friedman conceded that the Fugazys had not performed the payment and indemnity conditions precedent (pp. A-1556, A-1559-A-1560), but simply told the jury that such non-performance was meaningless and no "excuse" for Diners' failure to file by June 20. (pp. A-1560-A-1561)

Mr. Friedman was permitted, over objection, to adopt the S.E.C. statistic and testify that the Registration Statement of Diners should have become effective at the end of August, 1969, 70 days after it "should" have been filed. (pp. A-1521-A-1522) (See Point IV, *infra*)

This testimony was especially incompetent since Friedman had no knowledge of any of the facts and circumstances relating to the Registration Statement and concluded that Diners had failed to use its best efforts simply because the Registration Statement did not become effective. (pp. A-1524-A-1525, A-1538-A-1539, A-1545-A-1546) Furthermore, Friedman obviously had no knowledge of the S.E.C. 70-day statistic prior to being shown the re-

port by the Fugazys' counsel (pp. A-1521-A-1522). He even tried to describe the 70-day figure as an "average" and had to be corrected on cross-examination. (p. A-1573)

The Court below carried forward its erroneous treatment of the S.E.C. statistic into its jury charge, calling it an undisputed fact, and compounding the error by referring to the statistic as an average, rather than a median (p. A-1635) (See Point IV, *infra*)

Thus, Friedman was used by the Fugazys to assert, for the first time, a contract claim which comprised a conclusion that the Registration Statement had not been promptly filed, should have been filed by June 20, and should have become effective by August 29. This use of Friedman was completely improper, especially since cross-examination revealed that Friedman had been retained to testify prior to the trial (p. A-1533), and should have been called, if at all, only on the Fugazys' case-in-chief.

### **Friedman's Testimony Was Indispensable to the 1969 Claim Being Permitted to Go to the Jury and in Permitting the Jury to Reach a Verdict for the Fugazys Thereon**

At the close of the Fugazys' case, Diners moved for directed verdict on the 1969 claim. Although it denied the motion at that time, the Court stated: "I think they are in trouble on that one, frankly, for reasons even beyond what you have adverted to". (p. A-1338) The Court indicated the matter would be considered again at the close of the evidence. (p. A-1352) When the motion was reviewed at that time, the Court indicated that the Fugazys had made out a *prima facie* case *through Friedman* and permitted the claim to go to the jury. (p. A-1600) The Court commented that the legal issues raised on the motion were "very valid argument[s]" but suggested they be made to the jury. (p. A-1599) Without Friedman's improper testimony, the claim could not have gone to the jury. Furthermore, the jury verdict was based entirely on Friedman's improper construction of the Contract and the S.E.C. report. The

award of damages was based on a finding that the Registration Statement should have become effective on August 29 and comprised the market price on that day—\$23.50 (Ex. 48, pp. A-785, A-796)—less the \$15 price received by the Fugazys on the tender offer. (Ex. 26, p. A-657) This was acknowledged by the Court in computing interest. (D. 157, p. A-456) The jury's verdict thus necessarily included a finding that the Registration Statement should have been filed by June 20, in accord with Friedman's construction of the Contract. Had the jury decided on a date subsequent to August 29, the damages awarded would have been less. (Ex. 48, pp. A-796-A-798) Had the jury picked a date in December, there would have been no damages. (Ex. 48, p. A-797)

### **Statement of Facts Relating to the Counterclaims**

#### **A. Nature of the Counterclaims**

In 1967 Diners paid the Fugazys more than \$8 million in consideration for the assets of Fugazy Travel. The principal assets were represented to be a concept for the development of a franchise system of travel agencies, and the services of the Fugazys, particularly Plaintiff William Fugazy. (pp. A-1082-A-1083) Diners created a subsidiary, DFT, to operate this franchise system, and, as part of the agreement with the Fugazys, the Fugazys entered into employment contracts with Diners and DFT making Plaintiff William Fugazy the President and a Director of DFT, Plaintiff Louis Fugazy an employee and Vice-Chairman of the Board of Directors, and Plaintiff Otto Marx a Director and Consultant. (Exs. 7, p. A-618, 34, p. A-755, 36, p. A-765) Over the next three years, with the Fugazys in those executive positions, DFT lost \$30 million in the travel franchise business, finally terminating it and the employment of the Fugazys in 1970. (pp. A-1385-A-1386) Shortly thereafter the Fugazys commenced the instant action.

Diners counterclaimed, asserting *inter alia*, that it had been defrauded by the Fugazys into purchasing the assets of Fugazy Travel through misrepresentations and conceal-

ment of facts concerning the worth and nature of those assets, and also claiming that the Fugazys engaged in certain activities which constituted both a breach of the Contract and employment agreements with Diners and DFT, and a breach of their fiduciary duties to Diners and DFT. (D. 46, p. A-25, D. 168, p. A-482)

**B. 342 Madison Avenue-Travelco Inc. (N.Y.)**

Before the Contract was signed in 1967, Diners learned that the Fugazys had an interest in a company called Travelco, Inc. (N.Y.) ("Travelco"), which owned and controlled the franchise of Fugazy Travel for the principal New York territory located at 342 Madison Avenue. Diners required the Fugazys, by the terms of the Contract, to divest themselves of "any interest, direct or indirect," in Travelco.

*"4.6 Interest of Certain Individuals in Travelco Corporations. Otto Marx, Jr., William D. Fugazy and Louis V. Fugazy (hereinafter referred to as the 'principal officers') shall, at or prior to the time of the closing, have divested themselves of, and shall have caused all members of their respective families to divest themselves of, any interest that any of the foregoing may have had, directly or indirectly, in any franchise, in Travelco, Inc. (Pa.) and in Travelco, Inc. (N.Y.) [the latter being the office at 342 Madison Avenue]."* (Ex. 5, pp. A-542-A-543) (Emphasis added).

Diners insisted that the Fugazys sign an affidavit to that effect, as part of the closing documents, which read as follows:

*"Otto Marx, Jr., William D. Fugazy and Louis V. Fugazy, each being duly and severally sworn, for himself, deposes and says:*

*"That he and all members of his family have divested themselves of any interest, direct or indirect, that he or they may have had in any franchise, as that term is defined in the purchase agreement, dated October 10, 1967, between The Diners' Club, Inc. and Fugazy*

Travel Bureau, Inc., in Travelco, Inc., a Pennsylvania corporation, and in *Travelco, Inc., a New York corporation* [the latter being the office at 342 Madison Avenue]. (Ex. EEE, p. A-863) (Emphasis Added)

The employment agreements between DFT and the Fugazys each contained "non-compete" clauses which precluded them, during the terms of their employment, from having any direct or indirect interest in a franchise:

*"6.(a) In consideration of the execution by DFT of this Employment Agreement, the Employee agrees that for the period set forth in paragraph (b) below he will not, in any manner, directly or indirectly, engage in the business of providing travel or related service or licensing or franchising others to provide such services or in any business which competes with any of the fields in which Fugazy is presently engaged and he will not directly or indirectly own, manage, operate, join, control or participate in the ownership, management, operation or control of or be employed by or connected in any manner with, any corporation, firm or business that is so engaged without DFT's prior written consent. For the purposes of the foregoing, Travelco, Inc. (Pa.) and Travelco, Inc. (N.Y.) shall be deemed engaged in the travel business.*

(b) The period of Non-Competition referred to in this section 6 shall commence on the Effective Date and shall terminate (i) in the event this Agreement is terminated under section 4(a), one year after such termination and (ii) in the event Employee's employment as a full time employee is terminated under section 4(b), one year after such termination if DFT elects not to employ Employee as a consultant as hereinafter provided; and otherwise upon the expiration of the consultative period, as hereinafter defined." (Ex. 7, p. A-624, Ex. 34, p. A-761, Ex. 36, p. A-770).\*

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\* These provisions, proscribing such an interest in Travelco were also included in the Fugazys' amended employment agreements of October 1, 1968 (Ex. 22(a), p. A-645, p. A-655).

### C. The Fugazys' Interest in Travelco

On August 1, 1967, after a letter of intent had already been signed with Diners for the purchase of the assets of Fugazy Travel (Ex. 4, p. A-508), Plaintiffs William and Louis Fugazy entered into an agreement with one Irwin Fruchtman of Toledo, Ohio, reciting that the three of them were "holders of all of the outstanding shares of stock of Travelco, Inc., a New York corporation" and that:

"1. *Neither William, Fruchtman nor Louis shall sell, assign, transfer, encumber or in any way dispose of, except by the instrument admitted to probate as their last will and testament, any portion of their respective stock holdings in the Corporation, without the written consent of the other stockholders.* 2. . . . [A]t such time as a certain loan in the amount of \$99,000 from the Franklin National Bank to the Corporation has been fully repaid, the stockholders will vote their shares for a Board of Directors consisting of William D. Fugazy, Louis Fugazy and Irwin Fruchtman, a nominee of William D. Fugazy and a nominee of Irwin Fruchtman. 3. *The Corporation has borrowed the sum of \$99,000 from the Franklin National Bank on July 18, 1967, and Irwin Fruchtman has guaranteed payment of the Corporation's obligations pursuant to such loan, to the Franklin National Bank. William and Louis hereby agree to indemnify and hold Fruchtman harmless against any and all losses out of his guarantee to the Franklin National Bank of the Corporation's loan.* 4. *At such time as the Corporation's loan of \$99,000 has been repaid in full to the Franklin National Bank, William and Louis shall have the option, exercisable upon written notice to Fruchtman, to purchase from Fruchtman, for a total consideration of \$1.00, such number of shares of the stock of the Corporation owned by Fruchtman so that upon completion of the purchase William and Louis will each own thirty percent (30%) of the outstanding stock of the Corporation and Fruchtman will own forty percent (40%) thereof. Upon receipt of written notice*

from William and Louis of the exercise of such option, Fruchtman will promptly deliver to William and Louis certificates for the appropriate number of shares of stock of the Corporation for transfer on the books of the Corporation." (Ex. FFF, p. A-864-A-866) (Emphasis Added).

In addition to the Fugazy brothers' indemnity obligation and 60% ownership interest in Travelco, Plaintiffs Otto Marx and John Summerlin also had an interest in Travelco. On October 13, 1967,\* the Fugazys all signed an indemnification agreement, wherein Marx and Summerlin agreed to share equally with William and Louis Fugazy in indemnifying Mr. Fruchtman for his investment in the franchise at 342 Madison Avenue:

*"In connection with the agreement between both of you [the Fugazy brothers] and Irwin Fruchtman, pursuant to which you agreed to indemnify Mr. Fruchtman against any loss he may sustain by virtue of his investment of \$100,000 in Travelco, Inc., a New York corporation which is a party to a franchise agreement with the Corporation [Fugazy Travel Bureau, later known as F.T. Ventures, Inc.] for the New York City area, it is understood that the Corporation will indemnify you in event you are required to make any payment to Mr. Fruchtman pursuant to your agreement with him. Accordingly, if Mr. Fruchtman has not received payment in full of such \$100,000 from Travelco, Inc. prior to the liquidation of the Corporation [by October 13, 1968], Marx and Co., Inc. and John V. Summerlin will place \$50,000 in cash or its equivalent in a separate escrow at the time of such liquidation to secure their assumed share of the corporation's contingent indemnity liability to you, or will supply you with their personal guarantee. Such*

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\* This was after the execution date of the Contract, October 10, 1967 (Ex. 5, p. A-513), the closing of which took place on October 30, 1967.

escrow shall terminate if and when Mr. Fruchtman receives payment in full from Travelco, Inc., or at such time as you, Marx and Co., Inc. and John V. Summerlin shall mutually agree, and at such time any remaining amounts of such \$50,000 if deposited and held by the escrow agent shall be released to Marx and Co., Inc. and John V. Summerlin." (Ex. GGG, pp. A-867, A-871) (Emphasis added)

Plaintiff Otto Marx admitted that this indemnification agreement was not disclosed to Diners:

"Q. Did you disclose this indemnification agreement to Diners' Club in 1967, Mr. Marx?

A. I don't recall discussing it with them. (p. A-1432)

\* \* \*

[By the Court]: In the event that Mr. Fruchtman sustained the loss up to \$100,000 was he to be indemnified?

The Witness: Yes, sir.

The Court: Will you describe the manner in which he was to be indemnified and by whom?

The Witness: He would be indemnified for the entire \$100,000 if the Company, Travelco, had lost that much money, and 50% of this, or \$50,000 would be put up by William and Louis Fugazy, half each, 40% would be put up by Marx and Co. and 10% by John V. Summerlin." (p. A-1433).

Plaintiff William Fugazy admitted that it was not until several months after October of 1967 that Mr. Fruchtman recouped his money, so that the indemnity obligation was in effect at least until then:

"Q. Isn't it a fact that if the 342 Madison office [Travelco] lost money you were going to have to make it up in an indemnity and repayment of money to Mr. Fruchtman?

\* \* \*

A. I think the answer is no. I merely had to guarantee Fruchtman, as I recall it, if Travelco was not able to pay over the loan to the bank, and that was paid over very shortly. *I think they paid the loan off to the bank in six or seven months.*" (pp. A-1454-A-1455) (Emphasis added)

Plaintiff William Fugazy then admitted that once the loan from the Franklin National Bank was paid off, the Fugazys would automatically become 60 percent shareholders of Travelco:

"The Court: What about this period?

The Witness: Your Honor, the indemnity was not against losses. The indemnity was Fruchtman borrowed \$75,000 from the bank, and my brother and I guaranteed him if he had to make good on this loan we would make good, and that *after the Franklin Bank was paid off we would get 60 percent of the stock and he would get 40.*" (pp. A-1455-A-1456) (Emphasis added)

This uncontroverted evidence established that the Fugazys possessed, after becoming officers, directors and employees of DFT, a "direct or indirect" interest in Travelco in violation of the Contract and employment agreements with Diners and DFT.

#### **D. Diners' and DFT's Motions on the Counterclaims**

At the close of the evidence, Diners and DFT moved for a directed verdict on this portion of their counterclaims, on the ground that the evidence established that the Fugazys had breached the Contract and the employment agreements with Diners, contracts that had articulated fiduciary duties owed by the Fugazys to Diners and DFT. This motion was denied, and the jury returned a verdict against Diners and DFT. A motion after trial for judgment notwithstanding the verdict and for a new trial was also denied by the Court below.

### **E. The Improper Exclusion of Evidence Relevant to the Counterclaims**

In Diners' counterclaims for fraud and breach of a full disclosure covenant, contained in the Contract,\* Diners sought to establish that the Fugazys, including Mr. Marx, had concealed from and misrepresented and omitted to disclose to Diners material facts during their negotiations in 1967. Several rulings by the Court below aborted the development of these facts through the wrongful exclusion of certain evidence.

#### **a. Prior History of Fugazy Travel— The Non-Disclosure to Diners of Prior Fraud—The Tower Suit**

In 1963, Plaintiff Otto Marx, through a company organized by him for that purpose—Travelmarx, Inc.—purchased the assets of Fugazy Travel and the services of William Fugazy, from the then owner—Tower Credit Company ("Tower"), of which Mr. Fugazy was an officer.

In connection with the 1963 sale of Fugazy Travel to Otto Marx (Travelmarx), Tower obtained from the Fugazy brothers an indemnity against liability for the representations made to Marx in connection with that sale (Ex. J., pp. A-807, A-811).\*\* In that indemnity, the

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\* "2.21 *Disclosure*. No representation or warranty by Fugazy in this Agreement or in any Schedule or certificate or other document furnished or to be furnished to Diners pursuant hereto, or in connection with the transactions contemplated hereby, contains or will contain any untrue statement of a material fact, or omits or will omit to state a material fact required to be stated therein or necessary to make the statements contained therein not misleading or necessary in order to provide a prospective purchaser of the business of Fugazy and its Subsidiaries with proper information as to the business and affairs of Fugazy and its Subsidiaries." (Ex. 5, pp. A-513, A-539).

\*\* Travelmarx (Otto Marx) purchased from Tower in 1963 the assets of Fugazy Travel. Shortly thereafter, the name Travelmarx was changed back to Fugazy Travel. After the sale of assets of Fugazy Travel to Diners in 1967, that company changed its name to F.T. Ventures, Inc., and continued as a shell corporation, owned by the Fugazys, holding legal title to the Diners' stock and other consideration received by the Fugazys from Diners in 1967 (See, D. 127, p. A-145).

Fugazy brothers warranted to Tower that the representations made to Mr. Marx were "true and correct" (Id.). This indemnity was obtained by Tower from the Fugazy brothers, because it was William Fugazy who, as president of the travel company being sold to Marx (p. A-1141), had negotiated that sale with Mr. Marx. Indeed, prior to Marx's 1963 purchase, he had inquired of Mr. Fugazy as to the financial condition of the company (pp. A-1145-A-1146, A-1150) and Marx and Fugazy held some 25 to 50 meetings before Marx bought the company (p. A-1148).

Mr. Marx (through Fugazy Travel) in 1965 commenced a lawsuit against Tower (the "Tower Suit") asserting that he had been defrauded in connection with the 1963 purchase, and alleging that the financial condition of Fugazy Travel had been grossly misrepresented to him. According to the Complaint filed by Fugazy Travel, the representations made by William Fugazy to Mr. Marx were not "true and correct", but were false and fraudulent. The Tower Suit was terminated in August of 1967 (p. A-1436), shortly before the sale to Diners, but after Diners and the Fugazys had signed a memorandum of intent in July, 1967 (Ex. 4, p. A-508). In connection with the termination of the Tower Suit, Tower assigned to Mr. Marx all its claims against the Fugazy brothers, including its right of indemnity against misrepresentations made by the Fugazy brothers in the 1963 transaction (Ex. J, p. A-807, K, p. A-816).

When Diners sought to prove these facts at trial, the Court, asserting that such evidence would be prejudicial to the Fugazys, refused to permit inquiry into the Tower Suit, excluding from evidence the first step into that inquiry—the complaint by Fugazy Travel against Tower Credit Company (Ex. L for identification, p. A-923).

The Tower Suit was terminated in August, 1967. (p. A-1436) In connection with the termination of the Tower Suit, all the claims of Tower against the Fugazys, including the indemnity against the misrepresentations which were the very subject matter of the Tower suit (Ex. J, p. A-807) were assigned by Tower to Otto Marx personally

(Ex. K, p. A-816). The timing of the settlement of the Tower Suit in August, 1967 (p. A-1436), after the memorandum of intent with Diners (Ex. 4, p. A-508) had been signed in July 1967, and on the eve of the sale of Fugazy Travel and the services of the Fugazys, to Diners (Ex. 5, A-513, Ex. 7, p. A-618) makes it fair to infer that the Tower Suit was settled in an attempt to conceal its existence, and the facts surrounding it, from Diners. The Tower Suit was admittedly not disclosed to Diners. (p. A-1435)

Nevertheless, the Court below refused to permit inquiry into the Tower Suit, sustaining the vigorous objection of the Fugazys. (See, D. 127—Plaintiffs' Memorandum With Respect to the Admissibility of *Fugazy Travel Bureau, Inc. v. Ernst & Ernst* and *Fugazy Travel Bureau, Inc. v. Tower Credit Corp.*, p. A-145). Ironically, the Court below foreclosed inquiry into the circumstances of the Tower Suit, by excluding Ex. L, partly on the ground that the Tower Suit had been settled prior to the closing of the sale to Diners. (p. A-1440)

Another ground for exclusion was the Court's mistaken belief that the Tower complaint had never been filed in Court. (p. A-1442) Counsel for the Fugazys, well aware that the Tower suit *had* indeed been litigated in the Southern District of New York under Index # 65 Civ. 2152 (D 127, p. A-146), failed to reveal that fact to the Court during the lengthy bench conferences held to consider admissibility.

**b. Gross Overvaluation of the Assets of Fugazy Travel**

Diners also sought to prove the gross overvaluation of the assets of Fugazy Travel by the Fugazys, and the Fugazys' awareness of their false representations of the value of those assets, as further evidence of the fraud that was committed on Diners. In this connection, Diners sought to establish that, slightly more than one year prior to its purchase of the assets of Fugazy Travel for more than \$8,000,000, the Fugazys had attempted to sell the

assets of that company for \$250,000, plus the assumption of \$350,000 in liabilities. The purpose of offering evidence regarding the prior transaction was to establish the Fugazys' own awareness of the worthlessness of their company and to demonstrate that the motivation of the Fugazys during the year prior to the sale to Diners, in conducting certain allegedly fraudulent activities, was to prepare for the sale to Diners.

Diners sought, on three separate occasions during the course of the trial, to introduce into evidence a memorandum, on the stationery of Fugazy Travel, together with certain attachments, reflecting the Fugazys' offer to sell that company to Pierbusseti, Inc. for \$250,000 plus the assumption of \$350,000 in liabilities (Ex. H to H-4 for identification, pp. A-913-A922). This memorandum was delivered to Mr. Anthony Piscatella of Pierbusseti, Inc. by Plaintiff John Summerlin in May of 1966, in the midst of negotiations for the attempted sale of Fugazy Travel to Pierbusseti. (p. A-1357) The Court excluded this document from evidence on three different occasions. (pp. A-1139, A-1202, A-1361-A-1362)

***c. The Pitfalls of the Franchising Concept***

The Court below also refused to permit into evidence testimony by Mr. Piscatella to the effect that Mr. Fugazy was aware in 1966 of certain pitfalls in the franchising concept (pp. A-1358-A1359). Diners sought to prove that Mr. Fugazy had concealed these pitfalls from Diners in 1967. The Court excluded that evidence (pp. A-1358-A-1359).

## ARGUMENT

### POINT I

**The Court erred in refusing to apply the accord between Diners and the Fugazys as a bar or complete defense to the Fugazys' claims with respect to any alleged prior Diners' breach.**

The Court, relying on Rule 8(c) Fed. R. Civ. P., refused to apply the accord between Diners and the Fugazys reached on or around August 27, 1969, as a bar or complete defense to the Fugazys' claims with respect to any alleged prior Diners' breach, solely on the ground that Diners had not pleaded accord as an affirmative defense in its answers to the complaints herein. It is submitted that this holding was in error because it was based upon an improper application of Rule 8(c) Fed. R. Civ. P., and failure to apply Rule 15(b), Fed. R. Civ. P.

#### **A. The Improper Application of Rule 8(c) Fed. R. Civ. P.**

Rule 8(c) provides, in pertinent part, as follows:

*"(c) Affirmative Defenses.* In pleading to a preceding pleading, a party shall set forth affirmatively accord and satisfaction . . ." (Emphasis added)

In the instant action, there was no preceding pleading to which an accord could have been pleaded.

The complaint herein in its entirety, sets forth only one cause of action. (See, Statement of Facts, pp. 7-9, *supra*) That cause of action alleged a scheme by the defendants to defraud the Fugazys in violation of Rule 10b-5. The only reference in the complaints to the § 10.2 (b) of the Contract (which section, at trial, became the basis for plaintiffs' contract claim) was at paragraph 11 (h) of the complaint. (D. 33, pp.A-21-A-22, par. 11(h))

Nowhere in the complaint was it alleged that the filing by Diners was affected by any improper conduct. The plain meaning of plaintiffs' allegation in paragraph 11(h)

of the complaint was that the filing by Diners of the Registration Statement was proper and "pursuant to" the Contract, *but* the conduct as to causing the registration to become effective was improper. Even as to the latter allegation—that Diners' failed to use its best efforts—the Fugazys did not claim breach of contract but claimed that Diners defrauded the Fugazys in violation of Rule 10b-5 by representing in 1967 that it would use its best efforts, when it intended not to use its best efforts. The complaints sought damages only for fraud, and jurisdiction was alleged only pursuant to the 1934 Act; no pendent state law contract claim jurisdiction was alleged.

In the pre-trial order, dated February 13, 1975 (D. 115, p. A-48) five years after the commencement of suit and two and one-half months prior to the commencement of the trial, the Fugazys reiterated the claim that appeared in the complaints. Although, in the general statement of the nature of the claim the Fugazys varied slightly from the language used in the complaints, their specific contention on this point as set forth in the pre-trial order was almost identical to that set forth in the complaints. Again, no allegation was made that Diners failed to promptly file the Registration Statement, and no claim or allegation of contract breach was made. Only a fraud cause of action was stated and the only basis for jurisdiction alleged was the 1934 Act.

Since the accord would not have been a defense or bar against the claim of fraud pleaded by the Fugazys, there was no "preceding pleading", within the meaning of Rule 8(c), prior to trial, to which Diners could have pleaded accord as an affirmative defense. The earliest time that a claim was raised that Diners breached the Contract by failing to promptly file was at trial. The first and only witness to articulate this claim was Fugazys' expert witness, Stanley Friedman, who was called on the last day of trial by the Fugazys as a rebuttal witness.

Since there was no "preceding pleading", the application of Rule 8(c) to bar the defense of accord was in error.

Even if there had been a preceding pleading to which Diners could have pleaded accord, the failure to so plead would not be a bar to the application of the defense on the merits. See, *Mazer v. Lipshutz*, 360 F. 2d 275, 277 (3rd Cir. 1966), *cert. denied*, 385 U.S. 833, 87 S.Ct. 72 (1966), where the Court held that a defense of release was available to the defendants even though the defendants had failed to plead release as an affirmative defense in response to a preceding pleading.

#### **B. The Failure to Apply Rule 15(b) Fed. R. Civ. P.**

In the course of the trial, Diners introduced, without objection, evidence establishing an accord. (Ex. WWW, pp. A-889-A-890). This evidence clearly raised the issue of accord during the trial. In addition, in its motion for a directed verdict at the end of the presentation of its case, Diners raised this accord as a defense to the Fugazys' claims, again without objection by the Fugazys. (pp. A-1598-A-1599) The Court itself recognized that the accord argument was a "very valid argument which you could make to the jury. But I am inclined at this point to leave that to the jury." (p. A-1599)

While Diners claims that it was error to submit this issue to the jury (See Point I, § C, *infra*), there can be no question that it was tried. The provisions of Rule 15(b), Fed. R. Civ. P., which require that pleadings be deemed amended to conform to the evidence, are applicable. When issues are tried by express or implied consent of the parties, this Court has held that the provisions of Rule 15(b), to the effect that the pleadings shall be deemed so amended, are "mandatory not merely permissive". *Securities Exchange Commission v. Rapp*, 304 F. 2d 786, 790 (2d Cir. 1962).\*

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\* Since the Court in the instant case, *sua sponte*, deemed the Fugazys' pleadings amended after trial to include a claim for breach of contract under New York law, in order to reach the holding that pre-judgment interest should be awarded on the jury verdict in favor of the Fugazys, the Court's failure to apply Rule 15(b) to Diners' "accord" defense is inconsistent and especially improper (D. 157 p. A-456).

Rule 15(b) is applicable to defenses as well as to claims. 3 Moore's Federal Practice § 15.13[2] at 987; *Bradford Audio Corp. v. Pious*, 392 F. 2d 67, 73-74 (2d Cir. 1968).

Since the issue of accord, as an affirmative defense to the Fugazys' claim of contract breach, was raised and tried without objection, Diners' pleadings must be deemed to be amended to include this defense. The Court should have directed a verdict on this point or granted Diner's motion for a judgment notwithstanding the verdict, since this accord is an absolute defense to the Fugazys' claim, raised for the first time at trial, that Diners had failed prior to the accord to promptly file the Registration Statement.

**C. The Accord as a Bar to the Fugazys' Claims of a Prior Breach by Diners.**

Pursuant to Section 10.2(b) of the Contract, the Fugazys' as "notifying holders", were required to pay to Diners in connection with their delivery of a notice under that section, an amount sufficient to reimburse Diners for one-half of certain of the expenses to be incurred in connection with the Registration Statement, and to supply to Diners an indemnity agreement in customary form before Diners was required to file the Registration Statement. From the time the Fugazys delivered their notice in April, 1969, through August 27, 1969, they neither tendered any monies for the expenses nor supplied the indemnity agreement.

During this period, Diners advised the Fugazys of the amounts that had been incurred and the amounts that Diners was advised would be incurred in connection with the Registration Statement. Diners also advised them that it would not continue preparation or proceed with filing of the Registration Statement unless the Fugazys met their obligations with respect to payment and indemnity. The Fugazys refused to comply with the requests of Diners and sought to impose conditions, other than those contained in the Contract, with respect to payment and the indemnity.

Finally, in the period of August 25 through August 27, the Fugazys and Diners entered into an accord, to resolve

their differences with respect to the non-performance by the Fugazys of the conditions precedent and the filing of the Registration Statement by Diners. By the accord, Diners agreed that if the Fugazys,

- (1) signed and performed an agreement by which they acknowledged on behalf of themselves and F.T. Ventures, Inc., (a) that payment of an amount sufficient to reimburse Diners for one-half of the expenses to be incurred in connection with the Registration Statement was required to be made before Diners was required to file the Registration Statement, (b) that such payment had not been made, and (c) that plaintiffs Otto Marx and William Fugazy would each personally guarantee \$15,000 of the amount required to be paid by F.T. Ventures, Inc., and
- (2) delivered indemnity agreements in the form agreed to by their respective counsel,

then Diners would proceed with the filing of the Registration Statement.

On August 27, 1969, the Fugazys signed and delivered a written agreement (Def. WWW, p. A-890) acknowledging the prior payment condition, acknowledging that it had not been performed, and evidencing their undertaking to personally guarantee part of F.T. Ventures, Inc.'s obligation to Diners, all expressly to induce Diners to file the Registration Statement without having received the required prior performance from F.T. Ventures, Inc. The Fugazys also delivered the aforesaid indemnities. On August 28, 1969, Diners filed the Registration Statement.

By these agreements, the parties established an accord which provided Diners, among other things, with new promisors (Messrs. W. Fugazy and Marx, personally) as to payment of the Registration Expenses in consideration for Diners' agreement to proceed to file without having previously received payment from F.T. Ventures, Inc. The performance of the accord was fully executed by Diners and was not fully executed by the Fugazys, since they ultimately failed to pay their share of the expenses.

It is well-established in New York, that once an accord has been reached, a party to the accord cannot claim on the underlying prior contract unless it can show that the other party to the accord has breached the accord. N.Y. Gen. Oblig. Law § 15-501 (McKinney 1964). As was stated in *Plant City Steel Corp. v. National Machinery Exchange, Inc.*, 23 N.Y. 2d 472, 477, 297 N.Y.S. 2d 559, 562 (1969):

“It is clear that, in those instances in which an executory accord is present, a party can only prevail in an action on the underlying claim if the accord has been breached by the other party.”

See, also *Reilly v. Barrett*, 220 N.Y. 170, 115 N.E. 453 (1917); *Goldbard v. Empire State Mutual Life Insurance Co.*, 5 A.D. 2d 230, 171 N.Y.S. 2d 194 (1st Dept. 1958).

Diners' only obligation under the accord was to file the Registration Statement upon the delivery to Diners by the Fugazys of the indemnities and of the written acknowledgments of the non-performance of the conditions precedent and undertakings with respect to the guarantees. Diners' full performance under the terms of the accord bars the Fugazys, as a matter of law, from asserting any claim against Diners for any alleged prior breach with respect to the filing of the Registration Statement. Since, as a matter of law, there could be no breach of contract with respect to the filing of the Registration Statement on August 28, and since, even according to the Fugazys, the minimum period after filing for the Registration Statement to become effective was 70 days, the jury verdict that the Registration Statement should have been *effective* at the end of August is clearly erroneous as a matter of law.

A motion for a judgment notwithstanding the verdict must be granted if the verdict is against the weight of the evidence or if the verdict necessarily involved an erroneous determination of law. The standards to be used are clear.

“Whether the motion is one to direct a verdict or to set aside a verdict which the jury has returned, the

test applied by the court is the same. The evidence must be viewed in the light most favorable to the party other than the movant. The motion will be granted only if (1) there is a complete absence of probative evidence to support a verdict for the non-movant or (2) the evidence is so strongly and overwhelmingly in favor of the movant that reasonable and fair-minded men in the exercise of impartial judgment could not arrive at a verdict against him." *Noonan v. Midland Capital Corp.*, 453 F. 2d 459, 461 (2d Cir. 1972)

See also, *Sotell v. Maritime Overseas Inc.*, 474 F. 2d 794, 796 (2d Cir. 1973); *Fortunato v. Ford Motor Company*, 464 F. 2d 962, 965 (2d Cir. 1972), *cert. denied*, 409 U.S. 1038, 93 S. Ct. 517, 34 L. Ed. 487 (1972).

It is submitted that the Court below erred in refusing to grant Diners' motion for a directed verdict and for judgment notwithstanding the verdict as to the claim that Diners failed to promptly file the Registration Statement, because the Fugazys' claim was barred, as a matter of law, by the accord reached on August 27, 1969, and the jury verdict was, therefore, erroneous as a matter of law.

## POINT II

**The Court erred in holding that Diners could be liable for breach of a conditional contractual obligation on the ground that inaction of Diners prior to fulfillment of the express conditions precedent could have constituted hindrance or prevention sufficient to excuse forever their performance.**

It is undisputed, and the Court properly found, that, under the Contract, Diners' duty to promptly file a Registration Statement was expressly conditioned upon the prior performance by the Fugazys of the Payment Condition and the Indemnity Condition. It is also undisputed that at no time prior to August 27, 1969, did the Fugazys perform either of the foregoing conditions precedent (Statement of Facts, Section G *supra*).

After trial, Diners moved for judgment notwithstanding the verdict, on the grounds, *inter alia*, of the undisputed non-performance of the conditions precedent. The Court denied the motion, stating that although

“ . . . it is ordinarily true, as Diners’ argues, that a plaintiff must prove as an element of his cause of action for breach of contract the due performance by him of all conditions precedent, *see, e.g., Marine Trust Co. of Buffalo v. Gilfillan*, 258 A.D. 296, 17 N.Y.S. 2d 107 (4th Dept. 1939); 3A A. Corbin, On Contract § 628, at 16 (1960), it is equally well-settled that a party cannot insist upon a condition precedent when he himself has caused its non-performance. *Wagner v. Derecktor*, 306 N.Y. 386, 118 N.E. 2d 570 (1954).” (D. 145, pp. A-409-A-410)

The Court went on to state that the jury could have determined that upon receipt of the notice from the Fugazys, Diners:

- a) Did nothing,
- b) Failed to elect from among the options for performance available to Diners under the agreement,
- c) Failed to request a specific amount from the Fugazys representing one-half the registration costs, until July 15, 1969,
- d) Finally requested a sum considerably in excess of the reasonable expenses to be incurred, and
- e) Failed until August, 1969, to raise the question of plaintiffs providing an indemnity agreement.

The Court then held that the jury could have inferred from this conduct that Diners prevented or hindered performance\* by the Fugazys of the Payment Condition and the

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\* The Court did not explain how the jury could have inferred prevention or hindrance since this defense was never articulated by any of the parties and was never mentioned in the charge either as a contention or as a statement of the law.

Indemnity Condition so as to excuse forever their performance. It is respectfully submitted that the Court's holding on this point was in error, both as to the law and the facts.

Under the law of New York, in order for there to be prevention or hindrance sufficient to legally excuse non-performance of a condition precedent, there must be conduct on the part of the party who invokes the non-performance as a defense, which directly causes the non-performance.

"Waiver of the condition upon which the payment of commissions depends, occurs only where defendant's conduct actually hinders or interferes with its performance and not where he merely is passive." *Rosenberg v. Refco Facilities Corp.*, 59 Misc. 2d 25, 297 N.Y.S. 2d 1021, 1022, 1023 (Civ. Court, N.Y. Co. 1969)

The law is clear that merely passive behavior, in and of itself, will not excuse performance of a condition precedent.

"His promise to pay was conditioned and no more . . . Edward was not responsible for the default in payment under the agreement . . . True, he did nothing to enforce the agreement. *But passive acquiescence was not an act of prevention or hindrance.*" *Marine Trust Co. v. Gilfillan*, 258 App. Div. 296, 17 N.Y.S. 2d 107, 108 (4th Dept. 1939) (Emphasis Added)

Of course, inaction may constitute prevention or hindrance where the non-acting party has an affirmative duty to act and his inaction is a breach of that affirmative duty. *Wagner v. Derecktor*, 306 N.Y. 386, 118 N.E. 2d 570 (1954).

In the instant case, it is undisputed that Diners had no express prior affirmative duty with respect to the Payment Condition or the Indemnity Condition, such that Diners' failure to act could be deemed prevention or hindrance of the Fugazys' performance. Nevertheless, the Court held that Diners' inaction could be deemed prevention or hindrance. A necessary premise of the Court's

holding is a finding by implication that Diners had an affirmative duty to demand performance of the Payment Condition and the Indemnity Condition, or to give notice of election to the Fugazys, in order to be entitled to the Fugazys' performance of those express conditions precedent. There is no support for such a finding in the Contract or under the applicable law of New York.

It is a well-settled rule in New York that a Court may not rewrite into a contract conditions that the parties did not insert. *Frankel v. Tremont Norman Motors Corp.*, 22 Misc. 2d 538, 193 N.Y.S. 2d 722 (Sup. Ct. Bronx Co. 1959). In *Frankel*, the Court stated:

"Unless a contract is ambiguous or vague in its terms the intention of the parties must be gleaned from the four corners of the instrument. A court may not rewrite into a contract conditions the parties did not insert. The intent of the parties must be distilled from the terms of the written agreement itself (*Raner v. Goldberg*, 244 N.Y. 438, 155 N.E. 733; *Nichols v. Nichols*, 306 N.Y. 490, 119 N.E. 2d 351; *Williston on Contracts* Rev. ed. § 610). The court may not supply terms to an agreement under the guise of construction or interpretation. The court's power is limited to giving effect only to the parties' expressed intent (*Friedman v. Handelman*, 300 N.Y. 188, 194, 90 N.E. 2d 31, 34; *Matter of Loew's Buffalo Theatres*, 233 N.Y. 495, 501, 135 N.E. 862, 864; *Wilson Sullivan Co. Inc. v. International Paper Makers Realty Corp.*, 307 N.Y. 20, 119 N.E. 2d 573). As was stated in *Raleigh Associates v. Henry*, 302 N.Y. 467, at page 473, 99 N.E. 2d 289, at page 291: '\* \* \* we concern ourselves with what parties intended, but only to the extent that they evidenced what they intended by what they wrote.'"  
*Id.* at 725, 726

Nothing contained in the Contract can justify the holding of the Court that Diners was required to engage in affirmative performance as a condition precedent to the obligations on the part of the Fugazys to perform the

express conditions precedent. Indeed, it is incredible in the context of a detailed negotiated agreement such as the Contract, which contains express conditions precedent and a particularized description of the order of performance, that the Court should imply conditions to which the parties never agreed and which the Fugazys never even alleged.

The Contract is not ambiguous. The record is clear that, until the trial below, the parties understood the meaning of the express conditions precedent and the order of performance required by the terms of Sections 10.2(b) and (c). The fact that the Fugazys at the trial attempted to create the appearance of ambiguities in the Contract should not have influenced the Court. Thus, even though the Fugazys claimed at trial that the Registration Statement should have been filed on June 20, 1969, the record indicates that the Fugazys expressly acknowledged in writing at the end of August, 1969 (Ex. WWW, pp. A-889-A-890) their understanding and agreement that they were required to pay one-half of the estimated expenses before Diners was required to file and that such payment had not been made.

Moreover, it is a well established rule in New York that a party is not required to make a demand for performance of a condition precedent. *Witherell v. Lasky*, 286 App. Div. 533, 145 N.Y.S.2d 624 (4th Dept. 1955). *Witherell* was an action by a builder for the balance due on his contract to construct a house for the defendants. The contract contained an express condition precedent that "Before final payment, the Contractor shall submit evidence to the Owner [plaintiff] that all payrolls, material bills, and other indebtedness connected with the work have been paid."

The Court stated:

"Having reached the conclusion that the subject provision of the contract was a condition precedent, we find it was error to excuse non-compliance by the respondent contractor upon the ground that the appellant purchasers had made no demand for the evi-

dence required to be submitted by the builder. It is elementary that 'Where an agreement is absolute and unconditional the general rule is that no demand for performance is necessary before action may be brought thereon.' 17 C.J.S., Contracts, §478. *To read into the contract a requirement that the party for whose benefit the condition was inserted must make a demand for the performance thereof is but another way of stating that the clause is not a condition precedent, but a mere promise, the non-performance of which would not produce such a drastic result upon the rights of the party failing to perform.*"

"Although we recognize the harsh results which may be occasioned by a failure to perform a condition precedent are often softened by the doctrine of substantial performance, *Jacob & Young v. Kent*, *supra*; *Spence v. Ham*, 163 N.Y. 220, 57 N.E. 412, 51 L.R.A. 238; *Van Clief v. Van Vechten*, 130 N.Y. 571, 29 N.E. 1017, we cannot, on the other hand, excuse a complete failure to perform without either a valid reason for noncompliance or even an attempt to perform, the prerequisite considered by the parties sufficiently substantial to make it a condition precedent to payment. *Schultze v. Goodstein*, 180 N.Y. 248, 73 N.E. 21; *Smith v. Brady*, 17 N.Y. 173." *Id.* at 627, 628 [Emphasis Added]

Thus, Diners was not required to demand performance and its failure to demand did not hinder, prevent, or excuse the obligation of the Fugazys to perform the Payment Condition or the Indemnity Condition.

It is equally clear that, since the Contract did not contemplate that Diners would give to the Fugazys notice of election with respect to the performance possibilities available under Section 10(2)(b) of the Contract as a condition to the performance by the Fugazys of the express conditions precedent, the Court cannot imply such a condition. *Witherell v. Lasky*, *supra*.

In any event, the record clearly precludes any finding that Diners' conduct with respect to the alternatives to

registration could have in any way hindered or prevented the performance of the Payment Condition or the Indemnity Condition. As late as May 19, 1969, Marx requested by letter to Diners that no action be taken with respect to registration until he returned from Europe so as to not incur any costs or expense until possible alternatives to registration had been further explored and considered. In light of the May 19, 1969 letter from Mr. Marx (Def. Ex. MMM, p. A-873), there could be no finding that acquiescence by Diners to his request, made on behalf of the Fugazys, constituted a prevention or hindrance of performance by the Fugazys of the Payment Condition and Indemnity Condition. To so find requires the Court to hold Diners liable to the Fugazys for breach of a conditional contractual promise, where Diners defers the performance of that promise at the specific request of the Fugazys.

There is absolutely no factual or legal basis for the suggestion by the Court that Diners hindered or prevented the Fugazys' performance by first demanding a sum on July 15, 1969 and finally demanding an amount considerably in excess of the reasonable expenses to be incurred. The record indicates that in its July 15, 1969 letter to the Fugazys (Ex. PPP, p. A-879), Diners requested the sum of \$35,000 as the Fugazys' share of the estimated expenses. The amount finally requested was \$28,000 by Diners' letter of August 15, 1969 (Ex. QQQ, p. A-881), which explained that the estimate from Sorg Printing Company of the printing costs had by that time been reduced by \$11,000. No proof was offered by the Fugazys that either of the sums requested was in excess of one-half the reasonable expenses to be incurred in connection with such a registration statement. What is clear is that the Fugazys never in any way even attempted to tender any amount of money on account of their obligations under the Payment Condition. It is also clear that the requests for payment could in no way hinder or prevent the performance by the Fugazys of the Indemnity Condition.

In addition to all of the foregoing, it should be noted that acts of Diners in July and August of 1969 could not

have hindered or prevented the performance by the Fugazys of the Payment Condition and the Indemnity Condition during the period from April 16, when they sent their notice, to July 15, 1969, when the first such act by Diners is suggested to have occurred. This is particularly important because the Court's holding as to prevention and hindrance was to justify the failure to set aside a jury verdict that Diners breached the Contract on June 20, 1969. The Court failed to explain how the alleged excessive demands for expenses made by Diners in July and August could have relieved and excused the non-performance by the Fugazys of the express conditions prior to June 20, such that Diners was obligated in June to file a Registration Statement or be held liable to the Fugazys for a breach of contract on June 20.

The Contract on its face provided that Diners' obligation to file the Registration Statement was expressly conditioned upon the performance by the Fugazys of the Payment Condition and the Indemnity Condition, and contained no express conditions to the Payment Condition or the Indemnity Condition. Yet the Court, purportedly on the basis of New York law, reformed the Contract so as to require that Diners affirmatively cause the performance by the Fugazys. Not only did the Court hold that the Fugazys' performance was relieved during the pendency of Diners' inaction, but the Court actually held that failure of Diners to affirmatively cause performance by the Fugazys before particular dates, not mentioned or even alluded to in the Contract, forever relieved obligations of the Fugazys to perform the express conditions precedent. These holdings directly conflict with the unambiguous provisions of the agreement and the applicable law of New York. Moreover, a finding that Diners prevented or hindered performance of the Payment Condition or the Indemnity Condition is against the overwhelming weight of the evidence. Thus, the Court erred in refusing to grant Diners' motion for a directed verdict and judgment notwithstanding the verdict, and Diners' motion for a new trial.

### POINT III

**The Court clearly erred in permitting Friedman to construe the Contract and to misstate the rights and duties of the parties thereunder.**

The Court clearly erred in permitting the Fugazys' witness, Stanley Friedman, to testify as to the legal effect of the clear language of the Contract, and the intent and duties of the parties to the Contract. Friedman's testimony was irrelevant, incompetent, incorrect on matters of law, without factual basis, and in all respects, highly prejudicial.

The parameters within which a witness in a contract action may testify are clearly set forth, *infra*, in this Point III.

The Court, disregarding these parameters, not only permitted (p. A-1509, p. A-1513), but invited (pp. A-1542-A-1544) Friedman to construe the language of the Contract, and to give opinions on the intent, and duties, of the parties to the Contract.

#### **(a) Friedman's Testimony**

In his testimony on direct examination, Friedman proceeded, over the objection of Diners, to divine the intent and construe the legal obligations of the parties under the Contract, in non-responsive answers:

"Q. Would you tell the ladies and gentlemen of the jury the factors you considered in reaching that opinion?

A. Yes. The letter requesting registration was delivered on April 16th. The company had undertaken in its contract promptly to file upon receipt of the request—"

Mr. Santora: I object to that. He is characterizing.

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\* Paragraph 10.2(b) does not contain any language even remotely supporting this statement.

The Court: Yes, he is, but I will let him. He says this is the basis for his opinion. I will let him testify. You can cross examine him." (p. A-1509)

\* \* \*

"Q. What about the fact that the company may have used its resources to proceed in getting these other materials out that we have just mentioned?

A. The company assumed by contract an obligation to respond and to do things when asked. The fact that its people or some of its people might have been engaged in other activities does not, in my judgment, constitute a legal excuse for not fulfilling the unconditional contractual obligation that it undertook."\*

"Mr. Santora. That's not an expert opinion. That's a legal conclusion and I move to strike it."

The Court: It is his opinion. The jury can accept or reject it." (pp. A-1514-A-1515)

And in response to the next question:

"Q. Would the fact that some time between April 16, 1969 and August 28, 1969 the parties both the Diners' Club and the person who made the demand are exploring possible alternatives to the demand, would that affect your opinion as to whether or not Diners' Club in this case used their best efforts to promptly file this registration statement?

A. No, because Diners' Club should have begun immediately when they received the request to do that which should be done; therefore, I don't see that it excuses performance." (p. A-1515)\*\*

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\* Friedman not only erroneously construed the duty of Diners under the Contract but was, as counsel for Diners stated, giving an erroneous conclusion as to what constitutes excuse as a matter of law.

\*\* Contrary to Friedman's construction, both the Contract itself and Def. Ex. MMM (p. A-873) indicate the parties intended and engaged in an alternative plan to registration. Once again, Friedman states an opinion on the law, this time that pursuing a plan in the Contract and acquiescing in the request of the other party to the Contract to delay performance is both a breach of the Contract and not an excuse to a claim of breach of contract.

"Q. Does the fact that the person who made the demand was discussing with Diners' Club a possible alternative to registration in your view affect the Diners' obligation to promptly file?

A. No. In my judgment the fact that he was exploring alternatives does not constitute a waiver of his rights to have Diners' Club go forward." (pp. A-1515-A-1516)\*

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"Q. What is the basis of that opinion?

A. . . . I construe the term "best efforts" in the context of a covenant to register shares as the assumption on the part of the person who gives the covenant an absolute, unconditional responsibility to set to work promptly and diligently to do everything that would have to be done to make the registration statement effective.\*\*

Mr. Santora: I object. That's a legal conclusion.

The Court: He is giving his opinion. I will give him latitude and you can cross examine . . ." (pp. A-1512-A-1513)

Thus, Friedman was permitted, over objection, to testify on the intent of the parties and the law of contracts. In the examples cited, he was permitted by the Court to testify on the law of conditions, legal excuse and waiver and the legal definition of best efforts. Such testimony was on the very legal issues before the Court for determination. Nevertheless, the Court not only permitted such testimony over objection, but refused to strike stating that Diners could take up these matters on cross-examination.

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\* Again, Friedman is permitted to erroneously construe the Contract based upon faulty legal theories.

\*\* Friedman again trespassed onto the territory of the Court. He not only erroneously stated the legal definition of "best efforts" but erroneously construed its legal effect in the present case by concluding that the term "best efforts" creates an absolute, unconditional responsibility as if the "best efforts" undertaking existed completely outside of the Contract and was not affected by the express conditions of the Contract.

This was erroneous since the applicable law is not a question of fact to be decided by the jury after listening to legal exposition by a purported legal expert.

By these statements, all made in the presence of the jury, the Court left Diners no choice but to cross-examine Friedman in order to attempt to illustrate the variance between his testimony as to the intent of the parties and his legal conclusions of contract law, on the one hand, and the actual conduct of the parties and the actual conditions of the Contract, on the other hand. To have refrained from cross-examination after these statements by the Court would certainly have created the appearance that Friedman's improper testimony was not subject to challenge and must be accepted by the jury.

In addition, the Court's conduct curtailed the ability of Diners to effectively cross-examine Friedman. Friedman did not testify to facts upon which he could be challenged. He testified on legal theories using legal terminology. Diners in its cross-examination, attempted to impeach Friedman with a fact, the language of the Contract. Friedman, however, continued to construe and to misstate the Contract and reply with his erroneous opinions of law.

**(b) Friedman's Testimony Was Erroneously  
Admitted Parol Evidence**

Even if Friedman had been a party to the Contract with personal knowledge of the facts surrounding the negotiation and execution of the Contract, his testimony would have been inadmissible. Parol or extrinsic evidence is not admissible to vary the terms of a written contract. *Heller v. Pope*, 250 N.Y. 132, 164 N.E. 881 (1928). To permit otherwise would be to create a new contract for the parties. *Laskey v. Rubel Corp.*, 303 N.Y. 69, 100 N.E. 2d 140 (1951); *Trinity Episcopal School Corp. v. Romney*, 387 F. Supp. 1044 (S.D.N.Y. 1974) *modified on other grounds*, 523 F.2d 88 (2nd Cir. 1975). Before the parties may resort to extrinsic evidence, a showing of ambiguity in the contract is required. *Belden-Stark Brick Corp. v. Bronson & Popoli*, 48 A.D. 2d 845, 369 N.Y.S. 2d 172 (2d Dept. 1975).

Oral evidence is not admissible to create ambiguity where none existed before. *Zavota v. Ocean Accident & Guarantee Corporation*, 408 F. 2d 940 (1st Cir. 1969); *Intercontinental Planning, Ltd. v. Daystrom, Inc.*, 24 N.Y. 2d 372, 300 N.Y.S. 2d 817 (1969). Neither can a party raise a question of legal interpretation under the guise of a question of fact, and thereby seek to introduce parol evidence. *Agrashell, Inc. v. Composition Materials Co.*, 40 F.R.D. 395 (S.D.N.Y. 1966). Once ambiguity is established, a party is entitled to present evidence as to the circumstances surrounding the execution of the contract. The evidence may establish the intent of the parties at the time they entered into the Contract, but it may not vary or contradict the express or implied provisions of the written instrument. *Landon v. Twentieth Century-Fox Film Corp.*, 384 F. Supp. 450 (S.D.N.Y. 1974); *Nelson v. Frawley*, 186 F. Supp. 66 (S.D.N.Y. 1960); *Heller v. Pope, supra*.

Not even a party could testify to a factual interpretation of the Contract since there was no ambiguity in it. The Contract was a fully negotiated, fully integrated contract. The parties clearly expressed their intent in the Contract. Interpretation of the Contract must be limited to its four corners.

As a stranger to the Contract, Friedman's testimony was even more clearly erroneous. For a non-party may testify solely to clarify a contract term, which is shown to be not only ambiguous but technical. Furthermore, the non-party witness may only testify after his expertise in the area of the technical term has been established. As the District Court in *La Chemise Lacoste v. The Alligator Co., Inc.*, 59 F.R.D. 332 (D. Del. 1973) stated:

"It is black letter law that an opinion of a non-party witness as to the meaning of the terms of a contract is not admissible unless the witness qualified as an expert and it is shown that the terms in question are not used in their ordinary meaning." *Id.* at 332.

In the instant case, there was no showing of ambiguity. Neither was there a showing that the contract terms were

highly technical. In fact, Friedman himself acknowledged the Contract's language was not technical. When counsel for Diners asked Mr. Friedman the source from which he interpreted the contractual duties of the Fugazys (pp. A-1547-A-1548), Friedman replied:

"The contract that I have seen, my experience in the interpretation of contracts, and I would like to think my experience and use of the English language." (p. A-1548)

His testimony, therefore, was not addressed to a technical term, incapable of common understanding. By Friedman's own admission, the only qualification necessary to interpret the Contract was experience in the use of the English language.

**(c) The Attorney Witness**

Mr. Friedman, a non-party expert witness, qualified only in the specific field of securities regulations, should certainly have not been allowed to testify on the law of contracts, either as it is or as he views it to be. The well-established law limiting testimony which interprets a contract must be applied most rigidly when the non-party witness is also an attorney. The danger is acute that the attorney will construe the legal effect of the contract and that the jury will accept such construction.

In the instant case, Friedman's testimony was not only factually contrary to the terms of the Contract and the conduct of the parties in 1969, but replete with legal terminology and conclusions.

For example, Friedman was permitted to testify (p. A-1509, pp. A-1553-A-1554) as to a legal conclusion that Diners was required to proceed with and complete the filing of the Registration Statement, notwithstanding the request of the Fugazys (Ex. MMM, p. A-873) that Diners pursue alternatives so as to not incur any costs on the part of Diners and the Fugazys with respect to the preparation and filing of the Registration Statement. Friedman, in other words, was construing the Contract, not interpreting

purportedly technical and ambiguous terms, to the effect that if Diners acquiesced in, and agreed with, the request of the Fugazys, it would breach its contract with the Fugazys. Friedman also stated that the condition precedent of advance payment is "impossible of fulfillment" (p. A-1541) because it is "a very difficult thing to carry out." (p. A-1543)\*

Friedman, quite simply, was permitted to construe the legal effect of the Contract. He not only raised and resolved factual issues where none existed, but he raised and resolved the legal effect of the Contract. The Court clearly erred by permitting him to do either. As the Seventh Circuit stated in *Loeb v. Hammond*, 407 F. 2d 779 (7th Cir. 1969), in affirming the exclusion of the testimony of an attorney on the legal significance of the various papers signed by the parties:

"The question of interpretation of the contract is for the jury and the question of legal effect is for the judge. In neither case do we permit expert testimony. 3 Corbin on Contracts § 554, 226-27 (1960)" 407 F. 2d at 781.

By ignoring the reasoning of the parol evidence rule, and the strict limitations applicable to attorney witnesses, the Court permitted a fully integrated contract to be varied and contradicted by a non-party witness to the point that it no longer had any meaning, other than that ascribed to it by Friedman.

#### **(d) Friedman Testified Beyond His "Qualification" Under the Federal Rules of Evidence**

The foundation stone of the law governing expert testimony requires that a witness who gives an opinion as

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\* The prejudicial effect of his statement of this unique theory of law was heightened when the Court engaged in a dialogue with Friedman on this legal theory (pp. A-1541-A-1543). The jury reasonably could have inferred from this that Friedman's legal conclusions and construction of the Contract were of interest to the Court.

an expert in an area of "scientific, technical, or other specialized knowledge" must be "qualified as an expert". Fed. R. Evid. 702. The witness may not be qualified *sua sponte* while testifying. Rule 104 Fed. R. Evid. clearly requires that the preliminary question of the qualification of a person to render opinions as an expert "shall" be determined before his testimony by the trial judge. Although these requirements of qualification, as the clear language of Fed. R. Evid. 104 and 702 indicates, are mandatory, not discretionary, the Court, in a clearly erroneous disregard of these rules, permitted Friedman, qualified only in the field of securities regulations (p. A-1503), to testify beyond the scope of that field.

Friedman may properly have testified as to the meaning of terms such as "no-action letter" and "an indemnity agreement, in customary form", which were within the restricted area of his expertise. However, Friedman should not have been allowed to burst through the restriction of his area of qualification to testify in any other area and certainly not to discourse on contract interpretation and construction of the Contract.\* In fact, counsel for the Fugazys had represented that Friedman would be testifying "on the registration requirements of the Securities and Exchange Commission." (D. 134 Ex. A, p. A-232, p. A-296)

The qualification requirements for expert testimony are designed to prevent precisely what occurred in the instant action.

"It is clear that any question concerning the nature or extent of a witness' qualification should be decided by the judge before permitting the testimony. The

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\* A search of the record would indicate very few instances in which Friedman *did* testify to matters within his qualification. In one of his rare opinions within the area of his expertise, Friedman erroneously stated that in 1969, the SEC required a 10-K to be filed within 90 days, instead of 120 days (pp. A-1575-A-1576, pp. A-1510-1511; Def. Ex. WWW, p. A-904), making it evident that he had not been applying the law applicable in 1969 to events that occurred at that time but instead was erroneously applying the law in effect at the time of trial on a key point in his testimony.

potential confusion inherent in permitting a witness to draw inferences from the evidence, as well as the likelihood that the jury will accept such 'expert' conclusions and opinions as fact without exercising normal scrutiny makes it imperative that this sort of evidence can be admitted only after a preliminary determination of the witness' qualifications." Weinstein & Berger, 1 Weinstein's Evidence United States Rules § 104 [3], p. 104-26.

#### (e) Conclusion

The Court erroneously permitted Friedman to usurp its duty to determine if any ambiguity existed in a contract and the legal effect of a contract. Friedman was also permitted to testify in areas beyond his expertise. The effect of the errors of the Court was to mislead and confuse the jury to the substantial prejudice of Diners. As a result, not only did Friedman's testimony create issues where there were none, but it clothed an erroneous and improper opinion of law and fact with the mantle of expertise, laying the foundation for the jury's verdict.\* Diners should, therefore, be granted a new trial on the 1969 claim.

### POINT IV

**The Court erroneously took judicial notice of an irrelevant and prejudicial statistic and compounded the prejudice to Diners by allowing the Fugazys' expert to base his opinion on it.**

The Court erroneously took judicial notice, over Diners' objection, of the 36th Annual Report of the SEC and the statistics contained therein (p. A-1329), specifically the statistic that the *median* time between the filing of a registration statement and the effective date, for that fiscal period, was 70 days. The Court then improperly allowed Friedman to base his opinion on this irrelevant statistic.

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\* The Court itself suggested that the Fugazys made out a *prima facie* case solely through Friedman (p. A-1600).

The statistic itself was totally irrelevant, highly prejudicial and confusing, and not properly admissible. The statistic could not evidence the proposition for which it was purportedly introduced, i.e., that Diners had not used "its best efforts to cause such Registration Statement to become effective." The statistic did not represent a basis similar enough to the facts of the instant action to be the basis for any probative comparison. *Spartan Grain & Mill Company v. Ayers*, 517 F. 2d 214 (5th Cir. 1975); *Joseph E. Seagram & Sons v. Bynum*, 191 F. 2d 5, 21-22 (8th Cir. 1951); *Collins v. United Mine Workers of America*, 298 F. Supp. 964, 967 (D.C.D.C. 1969), *aff'd*, 439 F. 2d 494 (D.C. Cir. 1970); *Trans World Airlines, Inc. v. Hughes*, 308 F. Supp. 679, 684 (S.D.N.Y. 1969), *modified on other grounds*, 449 F.2d 51 (2d Cir. 1971), *reversed on other grounds*, 409 U.S. 363, 93 S.Ct. 647, 34 L.Ed.2d 577 (1972), *rehearing denied*, 410 U.S. 975, 93 S.Ct. 1434, 1435, 35 L.Ed.2d 783 (1973) *on remand*, 359 F.Supp. 783 (S.D.N.Y. 1973).

In the Contract, Diners only obligated itself to use its "best efforts" to make the Registration Statement effective. (See, Point VI, *infra*) Diners' "best efforts" are dependent on the circumstances and capabilities of Diners at a particular time. Diners did not undertake an absolute obligation to make the Registration Statement effective within a specific, set time, or even to make the Registration Statement effective at all. It is possible that a company may use its "best efforts" and a Registration Statement may still never become effective.\* The use of the statistic as a standard of performance substitutes an absolute, objectively determined standard for the more subjective standard set forth in the Contract.

The 70 day median statistic is irrelevant not only because it is a median, i.e., that more than half the registra-

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\* Indeed, the 36th Annual Report of the SEC indicates that for fiscal year 1970, only 3,329 of the 4,314 registration statements filed, ever became effective. 650 of those that did not become effective were withdrawn, for a variety of reasons (See, 36th Annual Report, p. A-930, p. A-938).

tion statements were in registration more than 70 days, but also because it is totally devoid of any information regarding the circumstances of the corporations from whose registrations the median was derived. Even if the statistic had been a mean, or true average, it would still be irrelevant, since the question was not what was the average time for a registration statement to become effective, but what were the circumstances with respect to Diners' obligation under the express language of the Contract.

The error of the Court below in taking judicial notice of the statistic was compounded by allowing Friedman, over objection, to adopt this statistic as a basis for his opinion that the Registration Statement should have become effective at the end of August, 1969; that is, 70 days after it "should" have been filed on June 20, 1969:\*

"Q. . . . Do you have an opinion as to when the registration statement, promptly filed in this case, should have been effective:

\* \* \* \* \*

"A. If you tell me it is 70 days, which is the figure given by the Commission as to processing time, if we start with June 20, which was the date I previously stated . . . About the end of August of the year 1969." (pp. A-1521-A-1522)

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\* The court carried forward its treatment of this statistic into its jury charge, calling it an undisputed fact, and compounding the error by referring to the statistic as an *average*, rather than a median, thus committing clear error in its charge to the jury:

"The Court has taken judicial notice of the 36th Annual Report of the Securities and Exchange Commission which states that the *average* time between filing of a registration statement and the effective date during the fiscal year ended June 30, 1970 was 70 days. The taking of judicial notice by the Court of a fact is a finding that *said fact is not subject to any reasonable dispute*. However, whether or not the Diners' registration statement would have become effective within the average time, that is, 70 days, is a question for you to determine from all of the evidence in this case." (p. A-1635) (Emphasis Added)

Even if the statistic had some minimal relevance, that relevance was far outweighed by the danger of unfair prejudice, confusion of the issues, or the possibility of misleading the jury.

In *Apicella v. McNeil Laboratories, Inc.*, 66 F.R.D. 78 (E.D.N.Y. 1975), Judge Weinstein confronted the question of allowing the contents of a medical newsletter to form the basis for expert testimony. Judge Weinstein excluded the evidence and clearly stated his reasons for doing so with regard to the responsibility of a trial judge under the Federal Rules of Evidence:

"Finally, the court must consider its responsibilities under Rule 403 of the Federal Rules of Evidence. *Relevant evidence may be excluded in the court's discretion, if its probative value is substantially outweighed by the danger of unfair prejudice, confusion of the issues, or misleading the jury, or by consideration of undue delay . . .* (citing authority)

"In evaluating these dangers we must bear in mind that the article, unlike a treatise, deals not with general background information, but with precisely the question which will be before the jury, the dangerous nature of this particular drug when used as directed by the manufacturer. Yet, it does so in a somewhat misleading way, for the issue is not the negligence of the manufacturer or its failure to be aware of dangers in 1974 when *The Medical Letter* was published, but the failures, if any, two years earlier, in 1972. Publication after the suit was commenced could have no bearing at all on the issue of notice.

"*There is a danger that the jury might focus on the accuracy of the 1974 article rather than on liability in 1972, when knowledge of the act may have been quite different. To the element of unfair prejudice in being unable to cross-examine experts who relied upon the article in arriving at an opinion, there is thus added the hazard of confusion and misleading of the jury.*" *Id.* at 86. (Emphasis Added)

See also, *Herman Schwabe, Inc. v. United Shoe Machinery Corp.*, 297 F.2d 906 (2d Cir. 1962), *cert. denied*, 369 U.S. 865, 82 S. Ct. 1031, 8 L.Ed.2d 85 (1962), *petition for rehearing denied*, 370 U.S. 920, 82 S.Ct. 1552, 8 L.Ed.2d 500 (1962). In the instant case, too, the issue should not have been whether Diners met an artificial median compiled after the fact.

The prejudice that Diners had already suffered in the Court's admitting this statistic into evidence was highlighted by having the statistic dignified and given a form of precision by the testimony of Friedman.\* The prejudicial effect was further compounded because Friedman was purportedly testifying on an ultimate issue. As the District Court stated in *TransWorld Airlines, Inc. v. Hughes*, *supra*:

"The more critical an issue is to a case, the more reluctant courts should be to determine it by taking judicial notice" 308 F.Supp. at 684.

Fed. R. Evid. 704, which permits expert opinion on an ultimate issue if otherwise admissible, is not supportive of the court's ruling. As pointed out above, the statistic was irrelevant, as was Friedman's testimony on it. Evidence which is irrelevant is not admissible. Fed. R. Evid. 402. As the "Notes of Advisory Committee on Proposed Rules" indicate:

"The abolition of the ultimate issue rule does not lower the bars so as to admit all opinions. Under Rules 701 and 702, opinions must be helpful to the trier of fact, and Rule 403 provides for exclusion of evidence which wastes time. *These provisions afford ample assurances against the admission of opinions which would merely tell the jury what result to reach, somewhat in the manner of the oath-helpers of an earlier day.*" (Emphasis Added)

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\* Friedman's testimony was further based on his erroneous belief that in 1969, the SEC required a 10-K to be filed within 90 days, instead of 120 days (pp. A-1575-A-1576, pp. A-1510-1511; Def. Ex. WWW, p. A-904).

Friedman's testimony, relying on the 70 day statistic, was also contrary to the facts of record. (See, Statement of Facts, Sec. I, *supra*) Such testimony, therefore, should have been excluded. See, *Bogacki v. American Machine & Foundry Co.*, 417 F.2d 400 (3d Cir. 1969); *Sheats v. Bowen*, 318 F.Supp. 640 (D.Del. 1970); *Coen v. American Surety Co.*, 120 F.2d 393 (8th Cir. 1941), *cert. denied*, 314 U.S. 667, 62 S.Ct. 128, 86 L.Ed. 534 (1941); *J. Gerber & Co. v. S.S. Sabine Howaldt*, 437 F.2d 580, 593 (2d Cir. 1971); *McFarland v. Gregory*, 425 F.2d 443, 448 (2d Cir. 1970); *Latham Holding Co. v. State*, 16 N.Y.2d 41, 261 N.Y.S.2d 880 (1965).

The Court, in support of the discretionary basis of its ruling permitting Friedman's testimony, cited *United States v. Cohen*, 518 F.2d 727, 737 (2d Cir. 1975) *cert. denied*, — U.S. —, 96 S.Ct. 270 (1975). The facts of *Cohen* are inapposite. In *Cohen*, the Chief of the Branch of Small Issues of the SEC was permitted to testify as the prosecution's expert on the concepts of "underwriter" and "materiality", issues which went to the "ultimate facts" of the case. However, in *Cohen*, the expert was testifying on the meaning of technical terminology, had established the bases of his expertise with respect to said testimony and was rebutting the expert testimony previously introduced by the defense. Accordingly, in that case, unlike the instant case, the trial court did not abuse its discretion in admitting the expert's testimony.

It is submitted that the Court erred by taking judicial notice of the 70 day median contained in the 36th SEC Annual Report and in permitting Friedman to base his testimony on it. This statistic, and Friedman's testimony based on it, were totally irrelevant, and highly prejudicial and confusing. This evidence severely prejudiced Diners' rights, since it is obvious that the jury's verdict is largely based on it. Diners should, therefore, be granted a new trial on the 1969 claim.

### POINT V

**It was prejudicial error for the Court to permit the Fugazys' expert witness to testify at all, since he was an improper rebuttal and surprise witness.**

Diners sought to preclude any testimony from Friedman, the expert witness presented by the Fugazys as a rebuttal witness, by objecting to his presentation on the grounds that he was a surprise witness and was not a proper rebuttal witness. Nevertheless, the Court overruled this objection and permitted Mr. Friedman to testify as the last witness in the trial. (D. 145, pp. A-412-413. n. 4, p. A-418)

It is concededly within the sound discretion of a trial judge to determine whether to allow rebuttal testimony. *Casey v. Seas Shipping Co.*, 178 F. 2d 360 (2d Cir. 1949). However, the exercise of that discretion must rest upon the circumstances of the particular case and must be designed to "make the interrogation and presentation effective for the ascertainment of the truth." Fed. R. Evid. 611 (a).

It is well established that rebuttal evidence is admissible only to explain away new material issues presented during the opposing party's case-in-chief. 6 Wigmore, Evidence § 1873 (3rd Ed.).

Friedman articulated for the Fugazys a claim that was not a rebuttal to Diners', but served to establish a part of the Fugazys', case-in-chief. Indeed that claim had never even been pleaded by the Fugazys in their complaints. Prior to trial the Fugazys had never alleged any impropriety with respect to the filing of the Registration Statement, yet Friedman was permitted to testify that, in his opinion, the filing of the Registration Statement on August 28, 1969 was not prompt and constituted a breach by Diners of the Contract. (See, Statement of Facts, *supra*).

Friedman, therefore, was not explaining away any new issues presented during Diners' case, but rather, was creating a new claim or at best attempting to supply part

of the Fugazys' case-in-chief.\* He therefore should have been called, if at all, before the Fugazys rested their case on May 14. The Fugazys were thus permitted to interfere with the presentation of Diners' case and were thereby permitted to make a final dramatic statement on their case-in-chief by presenting an expert witness on the last day of trial.\*\*

The inherent danger in permitting this type of gamesmanship has long been recognized in federal courts. See, *F. W. Woolworth Co. v. Contemporary Arts*, 193 F. 2d 162 (1st Cir. 1951) *aff'd*, 344 U.S. 228, 73 S.Ct. 222, 97 L.Ed. 276 (1952); *Skogen v. Dow Chemical Company*, 375 F. 2d 692 (8th Cir. 1967); *McVey v. Phillips Petroleum Company*, 288 F. 2d 53 (5th Cir. 1961). In each of these cases, the respective Courts would not permit a party to introduce evidence relevant and necessary to its case-in-chief under the guise of rebutting evidence brought out by the opposing party.

In fact, *Sanchez v. Safeway Stores, Inc.*, 451 F. 2d 998 (10th Cir. 1971), cited by the Court in support of its ruling, is, to the contrary, supportive of Diners' position. In *Sanchez*, plaintiffs presented their case without calling an expert. The defendants did not call an expert. They read from depositions of the plaintiffs, called a witness who had testified as an adverse witness and presented photographs. Plaintiffs, on rebuttal, called an expert. Defendants objected on the grounds that there was nothing new to rebut. The District Court ruled that the expert could only rebut what was shown by the photographs, but could not testify as to what he had learned by an independent investigation. In affirming, the Court of Appeals stated:

"The plaintiffs failed to exercise the opportunity to call their expert during their case in chief, apparently

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\* At the close of all the evidence, in denying Diners' motion for a directed verdict, the Court stated: "... I think through ... [Friedman] they made out a prima facie case" (p. A-1600).

\*\* The fact that Friedman was retained by the Fugazys to testify in this case *prior to the commencement of trial* (p. A-1533; See, Statement of Facts, *supra*) compels the conclusion that his presentation as a rebuttal witness was an intentional tactical act.

for tactical reasons. The trial court permitted them to rebut what was new in the evidence of the defense. We find no manifest error or abuse of discretion." *Id.*, at 1000

*Casey v. Seas Shipping Co.*, *supra*, another case cited by the Court, also does not support the Court's ruling. In *Casey*, the material introduced on rebuttal consisted of three depositions in which counsel for both sides had earlier participated. They were hardly new matter or material of which the opposing party was not aware. It was precisely for the latter reason that the Court of Appeals affirmed:

"This is a rather technical objection which, in the absence of surprise, of which none appears, deserves little notice." 178 F. 2d at 362

*Casey* illustrates that rebuttal testimony should be viewed with particular scrutiny when the "rebuttal" witness was "kept in the closet". Friedman was not only an improper rebuttal witness, but an improper surprise witness.

As indicated in the Statement of Facts, *supra*, the presentation of Friedman in this case was fraught with irregularities, including his undisclosed engagement prior to trial in an apparent attempt to conceal his identity and testimony until the last possible moment. In an attempt to justify what had happened, counsel for the Fugazys stated in a post-trial affidavit that he "did not finally decide to call an expert witness until after [he] had had the opportunity to hear and weigh the testimony of defendants' witnesses and review the documents introduced by defendants." (D. 137, p. A-297, p. A-313) Therefore, the "plaintiffs did not decide to call Mr. Friedman until May 16, 1975, after defendants had presented much of their breach of contract claim." (D. 138, p. A-337, p. A-363) The facts, quite simply, do not support this excuse, because by May 16, 1975, Diners had not presented *any* evidence on the Fugazys' breach of contract claim.

The prejudice caused by non-disclosure of an expert witness in a pre-trial order in and of itself has been deemed sufficient to exclude such testimony.\* See, e.g., *Valdesa Compania Naviera, S.A. v. Frota Nacional de Petroleiros*, 348 F. 2d 33 (3rd Cir. 1965).

The circumstances of the instant case far exceed mere non-disclosure in the pre-trial order. The case of *Stewart v. Meyers*, 353 F. 2d 691 (7th Cir. 1965), relied upon by the Court to justify its exercise of discretion in permitting Friedman to testify, is inapposite to the instant case. In *Stewart*, the identity of the "surprise" witness was known to the opposing party "long before" the date of trial. [353 F. 2d at 696]. Unlike the instant case, in *Stewart*, the witness was a witness on defendant's case-in-chief, not a rebuttal witness, not an "expert" and not a witness who supplied the essential elements of the case-in-chief. In the instant action, not only is the inherent surprise prejudicial to Diners, but if the conduct of the Fugazys' counsel is left unchallenged, the Court will be rewarding "gamesmanship" in contravention of the spirit of the Federal Rules.

While prejudice created by surprise can sometimes be overcome through a continuance, the prejudice created by the Court's error in permitting Friedman to testify in this case could not have been so cured. In the instant case, even though Diners did not call an expert to testify, the Fugazys were permitted to call Friedman as an expert witness. He was offered and qualified only to testify as an expert as to securities regulations (p. A-1503). However, Friedman's testimony consisted primarily of opinions and conclusions on contract interpretation and construction, to which Diners objected. In these circumstances, there was no expert or other witness who could

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\* This, of course, prevented Diners from conducting any discovery of Mr. Friedman's proposed expert testimony, pursuant to FRCP 26(b)(4). The Advisory Committee's Note to Fed. R. EVID 705 indicates that the liberalization of the admission of expert testimony at trial is predicated on, among other things, the fact that "the cross-examiner has the advance knowledge [of the expert's opinion and grounds for it] which is essential for effective cross-examination."

properly sur-rebut Friedman's testimony, since the substance of his testimony was improper and inadmissible (See Points III and IV, *supra*).

It is respectfully submitted that the Court abused its discretion in permitting Friedman to testify and that the prejudicial effect to Diners is so substantial as to warrant the granting of a new trial.

### POINT VI

**The jury verdict which is premised on failure by Diners to use best efforts to cause the Registration Statement to become effective is erroneous as a matter of law.**

The Court charged the jury, as a matter of law, the term "best efforts" as used in the Contract,

"Required Diners to do everything that would reasonably have to be done to cause the registration statement to become effective, so that in the normal course of events Diners' best efforts would result in the registration statement becoming effective." (p. A-1634)

Thus, in order for the jury to find Diners liable for a breach of its contractual undertaking to use its best efforts to cause the Registration Statement to become effective, after the Registration Statement was filed, it was necessary to find two elements, first, that Diners failed to do what reasonably had to be done, and second, that but for Diners' failure, in the normal course of events the Registration Statement would have become effective at a time when the Fugazys could have realized more than they actually received from the sale of their shares. The record clearly indicates that there was no proof from which the jury could find or infer that Diners failed to do what reasonably had to be done, *and* that but for this failure, the Registration Statement would have been effective on August 29, 1969.

In fact, the record is bare of any evidence as to an act that Diners should have performed and did not perform

in connection with the exercise of its best efforts to cause the Registration Statement to become effective. The only evidence in the record with respect to the Fugazys' claim on this point is the testimony of William Fugazy to the effect that Diners did, in fact, expend an enormous effort in trying to comply with its contractual undertaking, but that the problems to be resolved with the S.E.C. were "monumental" (See, Statement of Facts, Sec. I, J, *supra*).

Aside from the testimony by Plaintiff William Fugazy, who had personal knowledge of the events as the result of his status as an officer and director of Diners contemporaneous with the period in question, the Fugazys "best efforts" claim was premised solely upon the proof that the Registration Statement never became effective. From this fact the Fugazys sought to have the jury deduce that "best efforts" were not used.

Not only is the record bare of any evidence as to failure by Diners to do what should have been done to cause the Registration Statement to become effective, but the record indicates that delay was caused by reasons outside the control of Diners. One of the principal causes of delay was the need to await S.E.C. comments on the filed Registration Statement.

It is undisputed that once Diners received the S.E.C. comments, Diners diligently pursued resolution of the problems raised by the S.E.C. (See, Statement of Fact, Sec. I, J, *supra*). There is no evidence that at any time subsequent, Diners failed to engage in conduct in which it should have engaged and which caused the Registration Statement not to become effective. The only other evidence on this point is that the Fugazys disposed of their stock and therefore Diners formally withdrew the Registration Statement. (See, Statement of Facts, Sec. I, *supra*.)

The fact that the Registration Statement never became effective, cannot support a jury verdict that Diners breached the Contract since Diners had no absolute duty to cause the Registration Statement to become effective and it is clear that a registration statement may never become effective notwithstanding the exercise of best efforts.

Thus, there was no evidence in the record from which the jury could properly draw inferences, sufficient to satisfy the legal standard charged by the Court, in order to establish a breach by Diners of the best efforts contractual obligation. The jury verdict must, therefore, be set aside as being against the overwhelming weight of the evidence, and judgment entered in favor of Diners or a new trial must be granted.

The foregoing discussion and conclusion apply whether or not this Court finds, as Diners requests, that filing of the Registration Statement on August 28, 1969 did not constitute a breach of Diners' conditional contractual obligation with respect to prompt filing.

In addition, assuming *arguendo*, that a finding is supportable on this Record that Diners failed to use its best efforts, the Fugazys suffered no damages. Even if the problems raised by the comments of the S.E.C. had been resolved in the meetings throughout November (Ex. PP, p. A-822), the Fugazys' shares could not have been registered and sold until the Registration Statement had been amended and approved by the S.E.C., a process which of necessity would have carried at least into the second or third week of December, 1969, and probably into 1970. By the second week of December, 1969, the price of Diners' stock had declined to \$15 a share, which is exactly what the Fugazys received in the tender offer (Ex. 26, p. A-657; Ex. 48, p. A-785, p. A-797).

## POINT VII

**The Court erred in denying Diners' motions for a directed verdict and for judgment notwithstanding the verdict on Diners' counterclaims.**

The Fugazys were required, by the terms of the Contract, to divest themselves of all direct or indirect interest in any franchise, including Travelco (Ex. 5, p. A-513).<sup>\*</sup> They were required to execute an affidavit that they had

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<sup>\*</sup> The pertinent provisions of this Contract, and other exhibits referred to herein, are set forth in the Statement of Facts, *supra*, pp. 25-30, as well as in the exhibits themselves.

divested themselves of any such interest (Ex. EEE, p. A-863). They were required, by the terms of their employment agreements, to refrain from having any interest of any kind whatsoever in any business engaged in the "travel" business (which term expressly includes Travelco) during the course of their employment with Diners and DFT (Ex. 7, p. A-618; Ex. 34, p. A-755; Ex. 36, p. A-765).

The evidence presented at the trial demonstrated conclusively that the Fugazys, by obtaining or retaining an indemnity arrangement, option and an ownership interest, or any one of them, in Travelco, breached their Contract and employment agreements with Diners and DFT, while at the same time violating their fiduciary duties to those companies.

On August 1, 1967, in the midst of their negotiations to sell FTB to Diners and after a memorandum of intent with Diners had been signed (Ex. 4, p. A-508), William and Louis Fugazy entered into an agreement with one Irwin Fruchtman to indemnify Fruchtman on a bank loan obtained for Travelco (Ex. FFF, p. A-864). On October 13, 1967, the eve of the closing between Fugazy Travel and Diners, Marx and Summerlin joined with the Fugazy brothers in indemnifying Fruchtman for his investment in Travelco (Ex. GGG, p. A-867). This indemnification was not disclosed to Diners (p. A-1432), despite the fact that Diners made explicit its strong aversion to the Fugazys' having a conflict of interest or competing with and not devoting their full efforts to Diners and DFT by making the Fugazys warrant and represent that they would not do so in three separate documents on three separate occasions.

In addition to the indemnity, the agreement with Fruchtman (Ex. FFF, p. A-864) provided that the Fugazy brothers, once the bank loan was repaid, would become 60% owners in Travelco, by the exercise of an option to purchase 60% of Travelco at the price of \$1.00. The bank loan was paid off in six or seven months (pp. A-1454-A-1455) and the Fugazy brothers became 60% owners of Travelco (p. A-

1457). The Fugazys, therefore, had an interest in Travelco in 1967, through the indemnity and the option to purchase, and in 1968, through ownership of 60% of Travelco, all in breach of their agreements with Diners and DFT.

Not only did the Fugazys' acts breach their contractual obligations to Diners and DFT, but these acts also constituted a breach of the Fugazys' fiduciary duty to Diners as directors and officers of Diners and DFT. See, *Foley v. D'Agostino*, 21 A.D.2d 60, 248 N.Y.S. 2d 121 (1st Dept. 1964).

The Court denied Diners' motions for a directed verdict and subsequently Diners' motion for judgment notwithstanding the verdict, on the grounds that "[p]laintiffs denied retaining any interest in Travelco and testified that they had fully divested themselves of all interests, direct or indirect, by October 30, 1967" and that "it cannot be said that the jury's verdict was without support in the evidence." The only testimony of the Fugazys the Court could have been possibly referring to was the following questions and answers of plaintiff William Fugazy and his counsel, which did nothing but paraphrase, albeit incorrectly, the affidavit which Diners required the Fugazys to sign—Ex. EEE (p. A-863):

"Q. Mr. Fugazy, did you own on October 30, 1967, when you executed Defendants' Exhibit EEE in evidence, any interest in Travelco?

A. No. (p. A-1463)"

\* \* \*

"Q. Mr. Fugazy, this document is dated the 30th day of October, 1967. At the time you signed this document, did you have any interests, direct or indirect, in the companies referred to?

A. None whatsoever. (p. A-1465)"

All that exists is William Fugazy's\* bare (and legally erroneous) conclusion that he did not own "any interest,

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\* None of the other plaintiffs so testified.

direct or indirect," in Travelco on October 30, 1967. Even if this testimony of Fugazy is believed, at best, it raises a dispute only as to whether the affidavit of October 30, 1967 was false and whether the contract representation requiring divestiture was fraudulent or breached. However, it does not raise a dispute with William Fugazy's own admission and the corroborative documentary evidence, which prove that after October 30, 1967, and during the effectiveness of the employment agreements the Fugazys clearly and materially breached Section 5(a) of the employment agreements by entering into and taking the benefits of the indemnity arrangement, the option, and finally direct actual ownership of 60% of Travelco.

In any event, William Fugazy's testimony denying any interest on October 30, 1967, is contradicted by his admission that as of that date he was a party to the option agreement and, therefore, had at least an indirect interest, as a matter of law.\*

A trial court cannot abstain from denying a directed verdict simply because a "scintilla" of evidence exists, especially when the scintilla is merely a conclusory statement by a party which is completely contradicted by the party's own statements and the undisputed documentary evidence, such as in the instant action. See, *O'Connor v. Pennsylvania Railroad Co.*, 308 F.2d 911 (2d Cir. 1962).

Thus, the Court below should have granted Diners' motion for a directed verdict or for judgment notwithstanding the verdict on Diners' counterclaims. At the very least, the Court below erred in denying Diners' motion for a new trial on this point, since the verdict was clearly against the overwhelming weight of the evidence.

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\* An option alone is an interest cf. *Globus, Inc. v. Jaroff*, 271 F. Supp. 378 (S.D.N.Y. 1967): "The term 'security' means any . . . stock . . . or warrant or right to . . . purchase . . . the foregoing . . ."; 15 U.S.C. § 78a(10).

### POINT VIII

**The Court erred in excluding evidence relevant and necessary to Diners' counterclaims, thereby substantially affecting the right of Diners and DFT to prove their claims.**

The Court erred in prohibiting Diners and DFT from introducing certain documentary and testimonial evidence relevant and necessary to the proof of their fraud and breach of contract counterclaims.

As part of the claims, Diners sought to establish that the Fugazys had concealed from or omitted to disclose to Diners several material facts during their negotiations with Diners. The Court below aborted the development of these facts through the wrongful exclusion of the following evidence:

1) The circumstances surrounding the lawsuit entitled *Fugazy Travel Bureau v. Tower Credit Company*. (Ex. L for identification, p. A-923).

2) A memorandum, on the stationery of Fugazy Travel, reflecting its offer to sell that company in 1966 to Pierbusseti, Inc. for \$250,000 plus the assumption of \$350,000 in liabilities. (Ex. H for identification, p. A-913).

3) Testimony to the effect that Mr. Fugazy was aware in 1966 of pitfalls in the franchising concept, which were concealed from Diners in 1967. (pp. A-1358-A-1359).

The counterclaims of Diners included a claim for fraud against the Fugazys. The elements of fraud include a knowing misrepresentation or non-disclosure of material fact. The counterclaims also included a claim for breach of the contractual obligation of the Fugazys to disclose all material facts to Diners, based upon the omission or misrepresentation of certain material facts. The belief and knowledge of each of the Fugazys which the excluded evidence was intended to establish, is, therefore, a material and essential element of the counterclaims of Diners.

### A. The Tower Suit\*

The circumstances surrounding the lawsuit entitled *Fugazy Travel Bureau v. Tower Credit Company* (the "Tower Suit") were relevant and necessary to Diners' counterclaims for a number of reasons. An inquiry into the facts surrounding this suit would have established that Plaintiff William Fugazy had defrauded Plaintiff Marx in an earlier sale to Marx of Fugazy Travel, the very same company Marx and Fugazy later sold to Diners, which fraud consisted of an overvaluation of the assets of the Company, the same claim made by Diners. At the very least, an inquiry into the facts of the Tower Suit would have revealed that such allegations had been made by Mr. Marx. Since the services of William Fugazy were one of the principal assets purchased by Diners, the reputation and character of Mr. Fugazy and the knowledge and belief of Marx as to the Fugazys' reputation and character were material facts which should have been disclosed to Diners. Certainly the existence and circumstances of the Tower Suit were facts which Diners, as a prospective purchaser of the Fugazy Travel assets, was entitled to know.

In addition, the complaint in the Tower Suit (Ex. L, p. A-923) was relevant and necessary to enable the jury to understand Exs. J and K. The indemnity agreement between Tower and the Fugazy brothers (Ex. J, p. A-807), and the assignment in August, 1967 to Otto Marx by Tower of its claims against the Fugazys (Ex. K, p. A-816), while in evidence, were unintelligible in the absence of an understanding of the nature of the lawsuit which was settled in return for the assignment of the indemnity. Furthermore, the settlement of a fraud suit on the eve of sale of Fugazy Travel to Diners was itself a fact from which the jury could infer an attempt to conceal the existence of the suit from Diners.

Diners was also attempting to inquire into the truth of the matters stated in the Tower Suit. The relevance of

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\* A full explanation of the relevance of the facts surrounding this suit is set forth in the Statement of Facts, *supra*.

that evidence is beyond question. It is the very core of the claim of Diners that the Fugazys misrepresented the value of the assets of Fugazy Travel. Counsel for Diners stated all of these reasons in arguing the relevance of Ex. L to the Court. (pp. A-1435-A-1442) The Court, however, excluded the evidence, stating:

"Under the circumstances, the document not even apparently having been filed in this Court and being unsworn to, the maker of the document not being on the stand and available for cross-examination, there appearing to be an attorney's signature there, not the witness' signature, for all those reasons the objection is sustained." (p. A-1442)

". . . By saying that this in some way goes to Mr. Fugazy's character, it would seem to me that the prejudicial effect of this unsworn complaint outweighs its probative value." (p. A-1440)

None of the reasons stated by the Court was a proper ground for exclusion of Ex. L.\*

The document was properly authenticated and identified. Counsel for Diners accurately represented to the Court:

"That [the copy of the complaint] is the one I got from the Court file. I can inquire about it." (pp. A-1436-A-1437)

Counsel for Diners, therefore, supplied sufficient authentication, stating that the copy of the complaint came from "the public office where items of this nature are kept," and offered to provide further proof if the Court desired. Fed. R. Evid. 901(b)(7). Furthermore, counsel for the Fugazys in the brief they had submitted to the Court (p. A-1437), vigorously opposing the introduction of the evidence surrounding the Tower Suit, identified the complaint with its civil index number and the date filed in Court

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\* The Court applied Fed. R. Evid. 403 in excluding evidence on Diners' counterclaim, where the facts were uniquely within the knowledge of the Fugazys. Contrast Point III, *supra*.

(D 127, p. A-145, p. A-146). Therefore, through the authentication offered by the Fugazys in their brief, there was "evidence sufficient to support a finding that the matter in question is what its proponent claims." Fed. R. Evid. 901(a).

The Tower Suit was also relevant to provide evidence of the knowledge of Marx. Therefore, contrary to the determination of the Court below, it was not hearsay. Fed. R. Evid. 801(c); 4 Weinstein & Berger, Weinstein's Evidence United States Rules ¶ 801(c) [01], pp. 801-62, 801-63. Since the knowledge of Marx was material, the hearsay rule was inapplicable. Under this long recognized exception to the hearsay rule, the complaint was admissible. See, e.g., *Scholle v. Cuban-Venezuelan Oil Voting Trust*, 285 F.2d 318, 321 (2d Cir. 1960).

While this evidence may have reflected on the reputation and character of William Fugazy, this was not a proper ground for its exclusion. Since the reputation and character of William Fugazy was one of the primary assets purchased by Diners, his reputation and character were an issue in the suit. Therefore, this evidence was relevant and necessary and admissible. Fed. R. Evid. 405(b)

It has long been recognized that a claim of fraud is extremely difficult to prove. This is especially true where, as here, evidence of the knowledge and intent sought to be adduced are peculiarly within the control, if not only the mind, of the opposing party. In recognizing the problem of proof inherent in a claim of fraud, leeway is given to the claimant in producing evidence. For, as the District Court stated in *Gottlieb v. Schaffer*, 141 F. Supp. 7, 17 (S.D.N.Y. 1956):

"An intent to deceive is rarely capable of direct proof, since this involves what is in a man's mind. It is hornbook law that this subjective element may be established by circumstantial evidence. It is not any single element segregated from the whole by which the determination is to be made, but from the totality of all the acts, conduct and surrounding circumstances

and the inferences which may reasonably be drawn from a combination of acts and circumstances."

The probative value of the evidence, therefore, was not outweighed by any prejudicial effect.

#### **B. The Attempted Sale of Fugazy Travel Bureau in 1966**

The Court also erred in excluding Ex. H (for identification, p. A-913), a memorandum on the stationery of Fugazy Travel Bureau, Inc., reflecting the Fugazys' offer to sell that company to Pierbusseti, Inc. for \$250,000, plus the assumption of \$350,000 in liabilities. The memorandum was delivered to Mr. Anthony Piscatella of Pierbusseti, Inc. by plaintiff John Summerlin in May 1966 in the midst of negotiations for the sale of Fugazy Travel to Pierbusseti. (p. A-1357) Mr. Summerlin did not deny having seen the document. (p. A-1201) This evidence was offered and excluded from evidence on three separate occasions during the trial (p. A-1139, p. A-1202, pp. A-1361-A1362), apparently on grounds of authentication and relevance.

On the question of authentication, the fact that Ex. H was on the stationery of Fugazy Travel Bureau and was delivered by Plaintiff John Summerlin to Mr. Piscatella provides more than enough "evidence sufficient to support a finding that the matter in question is what its proponent claims." Fed. R. Evid. 901. Furthermore, it is well recognized that where no one can, or is willing, to directly identify a document, it may be satisfactorily identified by circumstantial evidence. If there was any remaining question as to the authenticity of the document, it was a matter of the weight the jury would give to it, and the Court below could have so charged the jury. Cf., *United States v. Imperial Chemical Industries*, 100 F. Supp. 504, 513 (S.D. N.Y. 1951).

The document was relevant because it evidences a fact in a chain of events which forms the basis for the claim of Diners, that the Fugazys, in the year prior to the sale to Diners, had fraudulently dressed up the value of the assets of Fugazy Travel with an "enhanced" franchise pro-

gram. The document becomes more meaningful when compared against Ex. F (p. A-802), a financial statement of Fugazy Travel Bureau for the period ending June 30, 1967. Ex. F indicates that in the period between the offer to Pierbusseti and the sale to Diners, Fugazy Travel lost money. From the difference in the price to Pierbusseti and that stated to Diners, the jury could reasonably have inferred that the Fugazys had fraudulently misstated the value of the assets of Fugazy Travel.

### **C. The Pitfalls of the Franchising Concept**

The Court below also erroneously precluded testimony by Mr. Piscatella that he had discussions with Plaintiff William Fugazy in 1966 regarding the franchising concept, and that during those conversations Plaintiff William Fugazy acknowledged pitfalls in the franchising concept which he did not disclose to Diners in 1967. The Court below excluded this testimony without explanation (p. A-1359)

The testimony was admissible as a statement by a party-opponent. Fed. R. Evid. 801(d)(2). Furthermore, as argued by counsel to Diners (p. A-1358-A-1359), the testimony was relevant to establish knowledge of Plaintiff Fugazy not disclosed to Diners, which as pointed out, *supra*, was a necessary part of the claim of Diners.

The admission of this evidence, and the other evidence referred to above, relating to facts and transactions which the Fugazys concealed from Diners, would, in addition, have helped to convince the jury that *other* facts, which the Fugazys said *were* disclosed to Diners, were, in truth, not disclosed.

The Court, in excluding all of the above necessary and relevant evidence, substantially affected the right of Diners to prove essential elements of its counterclaims against the Fugazys. Diners, therefore, should be granted a new trial on its counterclaims against the Fugazys.

### Conclusion

For the foregoing reasons (1) that portion of the judgment below awarding damages to be paid by Diners to the Fugazys in the sum of \$533,000, plus interest, should be vacated and an order should be entered as follows: (a) directing that judgment be entered in favor of Diners, or (b) directing a new trial on the issue of whether, following August 28, 1969, Diners used its best efforts to cause the Registration Statement to become effective, (2) that portion of the judgment below dismissing the counterclaims of Diners and DFT should be vacated and (a) judgment should be directed in favor of Diners and DFT, or (b) a new trial ordered; (3) costs should be granted in favor of Diners and DFT, together with such other and further relief as this Court deems just and proper.

May 17, 1976

Respectfully submitted,

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